

**Explaining corporate adoption of imported governance institutions in Latin America –  
the case of a voluntary corporate governance code in Peru.**

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“I, John Lewis Lawrence, confirm that the work presented in this document thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.”

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## Abstract

In this thesis I explain the compliance behaviour of individual corporations listed on the Peruvian stock exchange when confronted with a new voluntary code of conduct for corporate governance. Between 1999 and 2014, seven Latin American countries imported voluntary corporate governance codes catalysed by the OECD and modelled on the 1992 UK Combined Code (among other influences), despite extensive literature highlighting the inappropriateness of such codes in countries where controlling shareholders predominate. I explore the introduction of a voluntary corporate governance code in Peru in 2014 and provide a new theoretical framework supported by empirical evidence to explain how corporations that are more highly compliant are engaged in complex and idiosyncratic processes of negotiated legitimacy-seeking. These processes, as I show, involve a wide array of international and domestic agencies including the corporations' own employees. This mixed-methods study of the first seven years of the 2014 code shows that a significant number of corporations registered on the Lima stock exchange are prepared to trade compliance with international best practice standards of governance and increased transparency in their governance for wider participation in the international economy and for access to financial markets. Despite the legacy of concentration in very few hands of the control of corporations and the exclusion of two thirds of the population from a properly functioning wealth-generation market, some Peruvian corporations have shown themselves to be capable of evolving and taking into consideration a wider range of issues beyond their own success and survival. For these firms, the new transparency, commitment to ethical standards and openness to outside scrutiny embedded in the code provide a new institutional platform and language for improved governance, less corruption, and an authentic engagement with society and the environment.

## Research Impact

I hope that this research will have impact and relevance for four distinct interest groups. First, for policy makers and regulators interested in improving standards of corporate governance in both the listed markets and the large privately held family business market in countries, like Peru, that are dominated by control corporations. This research provides fresh insight into the factors that motivate firms to engage constructively with the challenge of good corporate governance. Second, for institutional scholars with an interest either in empirical evidence of institutional importation or in the related issue of the potential for institutional convergence between developing and developed economies. The research provides empirical evidence of the way in which imported institutions might be adapted to local circumstances and where there are likely to be areas of greatest contestation and friction with prevailing cultural norms. Third, for international financial markets, investors, including retail investors in Peru, and potential business partners, and those with an interest in interpreting the claims made by Peruvian corporations regarding their probity and their suitability as an investment or business partner. The research provides insight into corporations' openness to third-party engagement in their governance affairs and dealings with external stakeholders including shareholders, partners, and clients. Fourth, for Peruvian civic society whether dismayed by the lack of transparency hitherto in corporate affairs or for those excluded from Peru's main wealth-generation market because of the legacy of control exercised by a small proportion of the population. This research provides an insight into corporate responses to a voluntary code and a language with which to discriminate between firms that are engaging positively with societal and environmental issues and those that are less so engaged.

## **Ethics and Data Protection Registrations**

Ethics Approval: 20495/001 issued on 10/06/2021 extended on 06/07/2022 to 10/06/2023.

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## **Key words**

Latin America; Peru; corporate governance; voluntary governance code; independent directors; legitimacy; institutions; institutional importation; convergence; Bayesian Inference.

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## Abbreviations

AAFP	<i>Asociación de Administradoras Privadas de Fondos de Pensiones</i>
AFP	<i>Administradoras Privadas de Fondos de Pensiones</i>
AGM	Annual General Meeting
APESEG	<i>Asociación Peruana de Empresas de Seguros</i>
AUM	Assets Under Management
ASBANC	<i>Asociación de Bancos del Perú</i>
ASCLA	<i>Asociación de secretarios Corporativos de América Latina</i>
BVL	<i>Bolsa de Valores de Lima</i>
CADE	<i>Conferencia Anual de Ejecutivos</i>
CAF	<i>Corporación Andina de Fomento</i>
C/B	Cost-benefit
CED	Committee for Economic Development
CI	Compliance Index
CME	Coordinated Market Economy
COMEX	<i>Sociedad de Comercio Exterior del Perú</i>
CONFIEP	<i>Confederación Nacional de Instituciones Empresariales Privadas</i>
COP	Conference of the Parties
CPA	<i>Consejo Privado Anticorrupción</i>
CPO	Causal Process Observation
CSA	Corporate Sustainability Assessment
csQCA	crisp set Qualitative Comparative Analysis
CSR	Corporate Social Responsibility
DAG	Directed Acyclic Graph
DJ	Dow Jones
DMG	Decision-Making Group
DSO	Data Set Observation
DV	Dependent Variable
ESG	Environmental, Social and Governance
EY	Ernst & Young (rebranded)
FDI	Foreign Direct Investment
FONAFE	<i>El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado</i>
fsQCA	fuzzy set Qualitative Comparative Analysis
GDP	Gross Domestic Product
He	Efficiency Hypothesis
Hl	Legitimacy Hypothesis
H <sub>P</sub>	Power Hypothesis
HME	Hierarchical Market Economy
IBA	Independent Board Appraisers
IBGC	<i>Índice de Buen Gobierno Corporativo</i>
IFC	International Finance Corporation
INED	Independent Non-Executive Director – see NED
INEI	<i>Instituto de Estadística e Informática</i>
INDECOPI	<i>Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual</i>
INUS	Insufficient but Necessary part of an Unnecessary but Sufficient bundle
IPAE	<i>Instituto Peruano de Administración de Empresas</i>
ISO	International Organisation for Standardization
IV	Independent Variable

LART	Latin American Round Table
LME	Liberal Market Economy
LSE	London Stock Exchange
MEF	<i>Ministerio de Economía y Finanzas</i>
MDG	Millennium Development Goal
MILA	<i>Mercado Integrado Latinoamericano</i>
MLR	Multiple Linear Regression
NED	Non-Executive Director
NGO	Non-Government Organisation
NYSE	New York Stock Exchange
OECD	Organisation for Economic Cooperation and Development
PIR	<i>Principios de Inversión Responsable</i>
PRI	Principles of Responsible Investment
PUCP	<i>Pontificia Universidad Católica del Perú</i>
SBS	<i>Superintendencia de Banca, Seguros y AFP</i>
SDG	Sustainable Development Goals (UN)
SMV	<i>Superintendencia del Mercado de Valores</i>
SNMPE	<i>Sociedad Nacional de Minería, Petróleo y Energía</i>
SNP	<i>El Sistema Nacional de Pensiones</i>
SPP	<i>El Sistema Privado de Pensiones</i>
S&P	Standard and Poor
SRI	Socially Responsible Investment
SUIN	Sufficient but Unnecessary part of an Insufficient but Necessary bundle
SUNAT	<i>Superintendencia Nacional de Aduanas y de Administración Tributaria</i>
UCP	<i>Universidad Científica del Perú</i>
UKCC	UK Combined Code
UN	United Nations
UNEP	United Nations Environment Programme
UNGC	United Nations Global Compact



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## Chapter 1 The context for voluntary governance codes in Latin America

The topic of this thesis is an important one because corporate wealth generation in Latin America has historically been controlled by perhaps a score of top families in each country, thereby excluding the vast bulk of their populations to informality and relative poverty. The introduction of a corporate governance code into such a situation should be a matter of great interest because, to the extent that corporations comply, a code is the ‘thin end of the wedge’ of increasing transparency of, and scrutiny into, how corporations are run by including third parties into a hitherto private process. To explore this topic, I have developed an innovative methodology that combines depth interviews with corporate executives with extensive analysis of compliance records and uses Bayesian Inference to overcome any epistemological concerns about such mixing of methods. In this chapter, I first describe the development of the corporation, corporate governance, and the origins and role of voluntary codes, and set out why the introduction of such a voluntary code in the region presents a challenge. I then identify the central puzzle and the key research question, and finally set out the structure of the rest of the document.

### 1.1 The origins of voluntary corporate governance codes

The modern corporation<sup>1</sup> came about in the mid 1850s in the UK with the passing of four Acts of Parliament<sup>2</sup>. These Acts permitted the general use of incorporation and limited liability to separate shareholders’ wider assets from those invested in a corporation so that they were protected in the event of that corporation’s collapse (Johnson 2010: Chs. 4&5). Several theorists have attempted to capture the essence of the corporation,<sup>3</sup> but the need to

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<sup>1</sup> Precursors include the East India Company, one of the first publicly owned joint stock limited liability company and pursued an extractive strategy in India before becoming absorbed into the British Raj (Dalrymple 2019)

<sup>2</sup> 1844 Companies Registration Act, 1855 Limited Liability Act, 1856 Joint Stock Companies Act, 1862 Companies Act

<sup>3</sup> Corporation may variously be conceived of as: a real entity, a social fact emergent from social structures (Chassagnon 2014); an agentive function assembling a bundle of knowledge and competences (Nelson 1991); a

address the practical implications of the corporate form has proven more compelling. Just after the 1929 economic crash Berle and Means regarded the modern corporation as ‘*potentially the dominant institution of the modern world*’ (Berle and Means 2009[1933]: 356); their only caveat was to note the need to address the principal-agent problem<sup>4</sup> which would become a matter of great contestation for the next 50 years known as the era of ‘shareholder value’ or ‘shareholder capitalism’ (Lewis 2010: 225, Friedman 2002 [1962], 1970). Cieply sets out a cogent critique of the fixation on the principal-agent problem by emphasising that the public corporation was deliberately designed to maintain a crucial balance between investor plurality and its own contractual individuality<sup>5</sup> and that the very notion of the principal-agent problem represents a category error. After all, shareholders do not own corporate assets, rather they own tradable shares, and so face different financial incentives from true owners and can ‘exit’<sup>6</sup> by selling their shares. There are serious and compounding unintended consequences of this over-focus on shareholders’ interests, including short-termism, excessive corporate risk-taking and the over-rewarding of corporate executives (Cieply 2013:147,148). The net result of this process is, some authors argue, a crisis in corporate governance for which the UK Combined Code was presented as a solution.

Corporate governance is a broad term used to describe how corporations are directed at the highest level. It comes with several alternative definitions (Gillan and Starks 1998, Schleifer and Vishney 1997, Zingales 1997, Jensen and Meckling 1976, Daily, Dalton and Canella 2003, Dixit 2009) and has attracted a range of theories<sup>7</sup> (Davis, Schoorman and Donaldson 2004 [1997], Blair 2004 [1995]). In practice, many aspects of corporate

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legal fiction, essentially a nexus of contracts (Jensen and Meckling 1976); or as a semiotic entity in communication through signs and symbols with multiple audiences (Bau-Macedo and Herrmann-Pillath 2021)

<sup>4</sup> The principal-agent problem: the potential for a conflict of interest to emerge between principals (business owners) and their agents (business managers) due to e.g., information asymmetries or deliberate action.

<sup>5</sup> Separation of investors’ assets from the public corporation relies on three factors: asset lock-in, entity shielding, and limited liability (Cieply 2013:145)

<sup>6</sup> Exit, voice and loyalty (Hirschman 1970)

<sup>7</sup> Primarily Agency theory and Stewardship theory

governance are enacted by versions of ‘hard’ law such as criminal, corporate, securities, employment, and environmental law. But hard law only covers a small proportion of corporate behaviour and requires enforcement, and without transparency and due process corporate behaviour can still transgress standards of acceptability and give rise to externalities for third parties and abuse of minority shareholders.

Voluntary corporate governance codes first emerged in the US and the UK in the early 1990’s as a soft law<sup>8</sup> response to the need to resolve the principal-agent problem that had characterised shareholder capitalism (Lewis 2010: 225, Cieply 2013:147-8). In the UK for example, to address a shortfall in hard law and following several notable corporate scandals<sup>9</sup> and concerns over corporate misbehaviour (Jensen and Meckling 1976), in 1992 the UK authorities<sup>10</sup> established a committee, chaired by Adrian Cadbury, to explore a new form of soft law. This took the form of a voluntary corporate governance code (Cadbury 1992) which the committee envisaged as serving the interests of shareholders by keeping the board independent of managers, in order that it might hold the latter to account.

Cadbury’s report in 1992 was well-received: his recommendations were included in the listing requirements of the London Stock Exchange in 1994 and became known collectively as the UK Combined Code for Corporate Governance (UKCC) in 1998, which in turn led to a new Companies Act in 2006 and to over a dozen officially sanctioned committees<sup>11</sup>. This new code imposed a statutory obligation on corporations to report annually on dozens of requirements<sup>12</sup> on a ‘comply or explain’ basis<sup>13</sup>. The UKCC now

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<sup>8</sup> Soft law is a term used to describe quasi-legal instruments which do not have any legal binding force since soft law is often used in international contexts outside the jurisdiction of any single government.

<sup>9</sup> Polly Peck insolvency, BCCI bank collapse, Maxwell pensions scandal.

<sup>10</sup> Financial Reporting Council, London Stock Exchange and the accountancy profession.

<sup>11</sup> Greenbury (1995); Hampel (1998); Turnbull (1999); Myners (2001); Smith (2003); Higgs (2003); Tyson (2003); Turner (2009); Walker (2009); Shaman (2012); Davies (2011), Hampton and Alexander (2016); Parker (2017); and Wates (2018).

<sup>12</sup> Most voluntary governance codes stipulate dozens of requirements under heading such as: shareholder rights; board composition and process; conduct of the AGM; risk management; and transparent reporting.

<sup>13</sup> Comply or Explain: firms’ statutory returns must indicate if the firm complies with each requirement in the code or explain why it does not. Occasionally, codes use a comply *and* explain format.

receives near complete compliance from the FTSE listed sector<sup>14</sup> and has become a platform for the introduction of innovations in governance.<sup>15</sup>

Critics of the Combined Code cited the code's heavy reliance on the role of independent directors, its focus on institutional shareholders to the exclusion of societal stakeholders, its assumption of otherwise dispersed shareholders (Aguilera and Cuervo-Cazurra 2009, Spira and Slinn 2013), and an assumption of reflexivity<sup>16</sup> on the part of management (Veldman and Willmott 2016, Ailon 2011). Perhaps the most damning criticism of the UK Combined Code has been its over-focus on shareholder capitalism and the principal-agent problem to the exclusion of mechanisms to address wider concerns about corporate behaviour. These concerns include corruption, societal and environmental damage inflicted in pursuit of profits, and an explosion in CEO remuneration.<sup>17</sup>

Some of these wider concerns about corporate behaviour have been addressed in the global sustainability movement.<sup>18</sup> This is a broad term used to describe the convergence of at least three initiatives: Corporate Social Responsibility (CSR) which emerged in the US in the early 1970's to encourage corporations to address the needs of the wider society and non-shareholders (CED 1970, 1971); the Environmental, Societal and Governance (ESG) movement, which emerged in the 1980's as a reporting convention for corporations; and the Socially Responsible Investment (SRI) initiative directed at the professional investment

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<sup>14</sup> Annual report on UK FTSE compliance: Typically, over 60% of companies comply fully i.e. 100%, and non-compliance for any given rule is generally only a few percent, and always less than 10% of companies ([www.grantthornton.co.uk](http://www.grantthornton.co.uk))

<sup>15</sup> For example: majority INEDs on plc boards; INED presiding of and dominance on board committees; risk-based CEO remuneration; board gender diversity; separation of Chair and CEO roles; and best practice approaches to CSR (Pinsent Masons 2007).

<sup>16</sup> Reflexivity refers here to managements' ability to reflect on current governance practice and to revise it in the light of better or even best practice. In its 'strong form', 'double loop' reflectivity refers to the practice of reflecting on the values and beliefs that underpin current practice and not merely reflecting on the day-to-day practice itself (Ailon 2011, Veldman and Willmott 2016).

<sup>17</sup> During the period 1989 and 2007 the ratio of CEO to average worker remuneration increased in the US from 58.1:1 to 345.9:1 (Mishel and Wolfe 2019: <https://files.epi.org/pdf/171191.pdf>)

<sup>18</sup> See Appendix 1.2 for a description of the evolution of the sustainability movement from its origins Corporate and Social Responsibility (CSI), Environment, Society and Governance (ESG) and Socially Responsible Investment (SRI).

community. The United Nations acknowledges that the notion of sustainable development now includes all three aspects of ESG which, in turn encapsulates the CSR and SRI agendas (Gupta 2020: 2).

Despite the criticisms, the UKCC was well-received internationally: it catalysed the US Sarbanes Oxley Act of 2002 and, by 2004, 49 countries had implemented over 90 such codes in a wide range of contexts including many developing countries. Despite the UKCC's common law origins, these codes were adopted even in those countries with civil legal codes (La Porta, Lopez-de-Silanes, Shleifer and Vishny 1998, Aguilera and Cuervo-Cazurro 2004, Enrione, Mazza and Zerboni 2006, OECD 2019), although not all implementations were successful such as in the case of India which experimented with a voluntary code modelled on the UKCC in 1998 but soon opted for a mandatory approach (Varottil 2017).

## 1.2 Challenges for voluntary codes in Latin America

In Latin America the OECD acted as principal 'norm entrepreneur' (Finnemore and Sikkink 1998: 896) to introduce voluntary corporate governance codes. These were established in 1999 via the publication of *Principles of Corporate Governance*, substantially updated in 2004 (OECD 1999, 2004). Between 1999 and 2014, seven countries established governance codes based in part on the UK model:<sup>19</sup> Mexico and Brazil in 1999; Argentina, Colombia, and Costa Rica in 2007; Chile in 2012 and Peru in 2014<sup>20</sup> (OECD 2016 (c)). Such a global diffusion of the Combined Code and its mimics was consistent with convergence theory, which asserted that the institutions of developing countries would eventually converge on those of the developed economies, especially that of the United States (Branson 2004 [2001], 2012: 367). This was especially so in Latin America post-Washington

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<sup>19</sup> All the codes followed the UKCC model of mandatory reporting on a comply-or-explain or a comply-and-explain basis, but each country cited several sources of inspiration for their code design.

<sup>20</sup> Peru introduced a limited form of Principles in 2001 substantially updated in 2014 as a mandatory reporting code.

Consensus when many institutions were imported to support market liberalisation (Lora 2007).

However, on close inspection, the introduction of voluntary governance codes into the region might be thought problematic for four interrelated reasons. First, the principal-agent problem is not of overriding concern in Latin America because, it is argued, the form of capitalism pursued in Latin America namely Hierarchical Capitalism<sup>21</sup> or Hierarchical Market Economies (HMEs), does not generate the same degree of separation between principals and agents as in the Liberal Market Economies (LMEs) of the USA and the UK (Hall and Soskice 2001, Schneider 2013). In fact, Capaul considers that the principal-agent problem has been reformulated in Latin America as a problem occurring between control and minority shareholders, since controlling owners still occupy executive roles, so remain ‘agents’ (Capaul 2003: 4). In addition, as I will show, several countries have arguably more pressing issues than the principal-agent problem, including corporate corruption, disenfranchised, informal, and impoverished populations, and environmental concerns over resource extraction, which are not directly addressed by a voluntary governance code.

Second, Latin American economies typically lack the necessary supportive institutions that were identified by Spira and Slinn (2013) as being crucial for the successful operation of the original voluntary governance codes. Typically, they have relatively poorly developed stock markets<sup>22</sup> in comparison to G7 or more recent Asian ‘Tigers’; a shortage of large institutional investors willing and able actively to scrutinize corporate behaviour (Chong and Lopez de Silanes 2007, Capaul 2003, OECD 2020); few professionals able to work as independent directors; and a reluctance to enforce hard law to protect the rights of

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<sup>21</sup> Hierarchical Capitalism, or Hierarchical Market Economies (HMEs) are characterized by block ownership by elite families of horizontally diversified businesses, often with their own banks and insurers, positioned in markets where, through political influence and with family members in management roles, they can achieve dominant and profitable market positions by avoiding undue competition (Schneider 2013).

<sup>22</sup> In 2004, with between one half and one third of the market capitalization of the G7 and East Asian exchanges and between 6% to 7% of their trading volumes (de la Torre, Gozzi and Schmuckler 2008: 126)



minority shareholders. Also, many corporations in the region are likely to be more resistant to the introduction of third parties into their governance practice than were companies in the UK where compliance with the UKCC is high as noted. Much legacy governance practice has been derived from survival behaviours developed during decades of despotic leadership and volatile macroeconomics and so some family-owned corporations more closely resemble family fiefdoms than they do the corporations quoted in New York or London ([Monsalve 2014](#)).

Third, as with much of the institutional development under the Washington Consensus reforms of the late 1980s and early 1990s ([Lora 2007](#)), voluntary corporate governance codes have been imported albeit with some adaptation. The diffusion literature provides an additional perspective on the difficulties associated with international importation of institutions such as corporate governance: the issues of institutional weaknesses in the host country set out by Brinks, Levitsky and Murillo ([2020: 22](#)); the risk of states settling for legitimacy over efficiency, and so not pursuing the original objectives of imported institutions in order to please international audiences, noted as especially common in countries with Napoleonic legal traditions ([Zattoni and Cuomo 2008:13](#)); the potential for rule-dilution set out by Larsson-Olaison ([2018: 7, 8](#)); and the concerns about the persistent selfish behaviour of economic agents who undermine the operation of imported institutions noted by Pérez Caldentey and Vernengo ([2017](#)).

Fourth - a specific yet crucial point - the notion of independence in a board director, one of the lynchpins of the UKCC, represents a different organizing principle from the traditional parliamentary board where directors represent shareholdings. In HMEs, controlling shareholders may not only act as representative directors and serve on executive committees, but they are also likely to appoint the INEDs who therefore risk being compromised ([Schneider 2013, Varotttil 2020](#)). Such an arrangement provides INEDs with

substantial incentives to keep controlling shareholder directors satisfied, and so not to fulfil their key role of ensuring independence between the board and the executive ([Bebchuk and Hamdani 2017:1286, 1290](#)).

Finally, a voluntary governance code would be at a natural disadvantage in Latin America with its civil law legislatures deriving from Napoleonic traditions in which hard law is written in referable documents and infrequently altered. A voluntary governance code is a form of soft law, a non-binding set of rules or prescriptions that are assumed to have normative purchase because, depending on the circumstances, it points to desirable or best-practice behaviours ([Broude and Shereshevsky 2021: §5.1](#)). Soft law has more of a natural affinity with common law jurisdictions where the state may delegate to other agencies, in the main the judiciary, the task of establishing precedent and so de facto binding future interpretations of law. The judiciary does not have this freedom in Latin America<sup>23</sup>. It is no coincidence that the first voluntary codes were established in the common law jurisdictions of the UK and the US. This apparent affinity between soft law and common law is underscored by Guzman and Meyer who coin the term *international common law* to characterize the delegation of the creation of international soft law by states to international courts and tribunals ([Guzman and Meyer 2010](#)). It is a reasonable expectation, all things being equal, that soft law will be taken less seriously by the affected actors in a civil law jurisdiction than it would have been by those operating under common law. Moreover, it might also seem unlikely that ‘single loop’ reflexivity on governance practice will occur, let alone the ‘double loop’ reflexivity of the values underpinning capitalism in the region as described by Ailon ([2011](#)) and Veldman and Willmott ([2016](#)). Implementation of a soft law code in the region might reasonably be considered culturally problematic.

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<sup>23</sup> In civil law jurisdictions, the judiciary are free to interpret law, but this has no binding effect on future judgements, so the principle of *Stare Decisis* does not apply ([Diez and Reinhart 2023](#)).

In summary, the introduction of a voluntary comply-or-explain corporate governance code would seem to present a challenge to regulators in Latin America.

### **1.3 The central puzzle**

The importation of a voluntary corporate governance code to Latin America, albeit modified to suit local mores, seems *prima facie* to be a challenging task. In Anglo-Saxon economies, voluntary governance codes are, at best, sub-optimal at reducing externalities, due to their over-focus on the principal-agent problem. Such codes would appear to be even less applicable to Latin America for all the reasons previously stated.

Understanding state motivations for undertaking such an initiative would be an interesting task, especially for the seven countries that adopted voluntary governance codes in a relatively short period following the OECD's intervention. No doubt there was a desire to achieve a practical outcome, to improve the governance of their corporate sectors in practice. There may also have been a desire to improve the perception of corporate governance in each country; there may have been some 'norm cascade' (Finnemore et.al. 1998: 896-898) or a 'California effect, race to the top' (Vogel 1995:248 - 270), to compete for foreign direct investment (FDI), or to improve the reputation of local stock and capital markets, and some countries may have perceived the potential 'audience value' (Brinks et.al. 2020: 25) of such an initiative and considered it a pre-cursor to membership of international bodies such as the OECD.

However, the more puzzling question and one which is not addressed fully in either the governance or the institutional literature, is why would publicly listed corporations in Latin America seek to comply with such a voluntary corporate governance code and what factors do corporate leaders consider in their decision-making?

*Prima facie*, the adoption of a voluntary code to replace some aspects of legacy governance practice would represent an additional business expense – at the least in

designing, implementing, and operating new procedures - and so one would expect corporate leaders to seek compensatory benefits for assuming such additional costs. There may be opportunity costs associated with new practice because increased transparency inhibits hitherto covert behaviours. Much more challenging would be the introduction of new participants such as independent directors and new deontic rights and responsibilities into governance processes that had hitherto been the preserve of the principal owners of the business, often from the same extended family. Why would they take this risk unless there were some compensatory upside? In this thesis, I will explore these questions and develop new theory to explain corporate adoption of a new voluntary governance code.

#### **1.4 The structure of this thesis**

This thesis is structured around addressing the central puzzle by establishing and then exploring through research a theoretical explanation for corporations' behaviour regarding a newly introduced voluntary governance code.

In Chapter 2, I develop a theory to explain corporate decision-making regarding the adoption of a new voluntary governance code based on existing literature in the fields of philosophy, neo-institutionalism, and soft law. The theory comprises four important components. First, my focus will be on the so-called constitutive rules that seek to introduce third parties into corporate governance, something that is not at all common on boards in the region. Second, I will identify three rival explanations<sup>24</sup> for corporate decision-making in relation to corporate compliance with a voluntary code, between which I discriminate empirically using Bayesian Inference. Third, I will lay out how these rival explanations

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<sup>24</sup> These are: 1. the expression of elite power towards compliance manifest in a range of strategies aimed variously at deflection or subversion of the code imposition process and at cost avoidance; 2. pursuit of economic efficiency based on a rational choice, instrumental and self-interested evaluation of costs and benefits; 3. pursuit of legitimacy based on a judgement about the relative appropriateness of governance behaviours as perceived by external influencers. The hypotheses are designed to be rivals because I plan to use Bayesian Inference to assess evidence in order to discriminate between them.

coexist in firms, they are strategies that are always available to boards and can apply to decisions about code compliance as well as to other areas of corporate business. Finally, there will be equifinality in any examination of corporate decision-making in recognition of the fact that corporations are autonomous and subject to their own idiosyncratic set of influencing factors. In the rest of the thesis, I will explore this theory empirically and provide an updated theory which better fits the cases chosen.

In Chapter 3, I present Peru as a country case study. Peru introduced a full voluntary governance code in 2014. Peru is in several ways typical of the other countries in the region which launched codes: it has a legacy of family-owned businesses operating within a tradition of hierarchical capitalism, with limited financial markets, a civil law legislature, and limited experience of the principal/agent problem for which voluntary codes were first invented to tackle. However, Peru presents some unique characteristics that make it an especially interesting case study. Peru achieved, until 2020, consistent economic growth, while having the poorest reputation for corporate governance in the Pacific Alliance, and its legacy of listed firm corporate governance is considered especially exclusionary with societal divisions and inequalities that are clearly framed in racial terms. It was also complicit in the *'the largest-ever global foreign bribery resolution'* as Odebrecht's main staging-post outside Brazil (Simon 2019).

In Chapter 4 I discuss the data available on corporate compliance in Peru and develop a methodology to discriminate between the three rival explanations for decision-making regarding compliance with Peru's 2014 code based on in-depth interviews with corporate executives and extensive analysis of corporations' compliance records. I address and resolve any epistemological issues arising from my choice to use mixed research methods by applying Bayesian Inference to inform my judgement. The ensuing three chapters provide the results of my research.

In Chapter 5 I present an analysis of corporations' compliance records and identify several factors that are strongly associated with higher levels of corporate compliance with the governance code. This phenomenon becomes especially apparent in relation to the constitutive rules comprising the code, to which corporations are most resistant. Constitutive rules are essentially 'game changers' because they either introduce third parties into corporate governance (such as independent directors) or create new deontic rights and obligations for actors already involved. Six factors and their interactions explain 45% of the variance in compliance between corporations and provide a basis for claiming sufficiency causality of high compliance with the constitutive aspects of the code. The multiplicity of combinations of these factors explains the evident equifinality in outcomes.

In Chapter 6 I use Bayesian process tracing to explore compliance with the 2014 code in eight corporations. These case studies confirm that corporate decision-making regarding governance is influenced by domestic and international value chain partners in their domains including financial institutions, global branded suppliers, foreign parent companies, project partners, and crucially their own employees. These actors are keen to evaluate firms as acceptable partners and can bestow legitimacy on corporations with whom they have ongoing relationships; some corporations are prepared to trade greater transparency in their affairs and the involvement of third parties and employees in corporate governance for legitimacy with these actors.

In Chapter 7 I trace the development of an institutional ecosystem in Peru which somewhat compensates for the initial weakness in key institutions and provides support to corporate governance. This ecosystem combines growth in existing institutions, the importation of international institutions and Peru's reaction to the global sustainability movement and to the Odebrecht scandal. These developments have raised the saliency of corporate governance in Peru and they greatly expand the number of and type of institution

that are aligned with better corporate governance. Crucially, these actors provide information in a synergistic manner on a range of other aspects of corporate governance not directly associated with the code, such as credit ratings, anti-bribery procedures, environmental protection procedures and sustainability initiatives.

In Chapter 8 I use Bayesian Inference to highlight evidence from Chapters 5, 6 and 7 which discriminates between the rival explanations of corporate decision-making, and so informs my judgement about the prevailing decision-making processes. I conclude that corporations demonstrating high levels of compliance with the code's constitutive rules are engaged in a process of legitimacy-seeking with their regulators, business partners, and financiers. The other two explanations - the pursuit of economic efficiency and of corporate power - I associate with lower levels of compliance and a desire to obfuscate true governance practice. I then present a revised theory of corporate decision-making based on the empirical evidence highlighted in Chapters 5, 6 and 7. My central conclusion is to elaborate a multi-level model of how agents in the corporation's domain organise themselves into the roles of Evaluator and Judgement Validator and how both are sought after by certain corporations. I also elaborate on the original rival hypotheses to confirm the other elements of the original theory: that all the rival mechanisms are potentially in play in each organisation, and that there is widespread equifinality in the processes that lead to high constitutive compliance.

I conclude in Chapter 9 with a discussion of the robustness and relevance of the revised theory as well as its implications for policy makers, and international investors and agencies, and I identify relevant areas of the academic literature to which this thesis might contribute.

## Chapter 2 Theory to explain corporate compliance with a new code.

### 2.1 Introduction

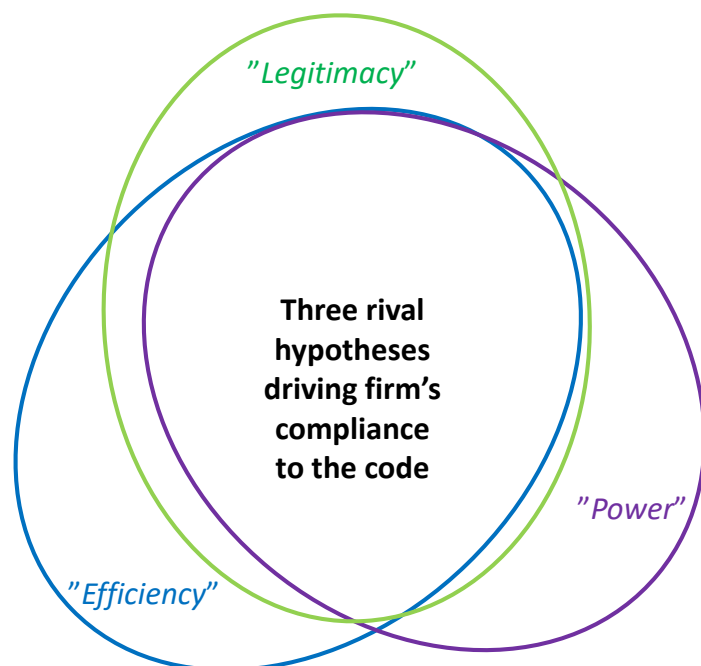
In this chapter I develop a theory to explain corporations' responses to a new voluntary corporate governance code based on existing literatures. I use this theory to define a research question and a set of rival explanatory hypotheses.

There are two points I must clarify to set the context for this theory because a voluntary governance code has a dual nature: it may be viewed both as soft law and as an institution. First, I refer to a voluntary governance code as soft law; that is, a member of a class of business regulations and codes of conduct consisting of guidelines, tacit agreements, and rules, which are intended to shape the behaviour of corporations, but which are outside the ability or desire of states to enforce. In this spirit, although the code is expressed as a list of questions, these questions represent best-practice guidelines or rules of behaviour, and so for brevity I refer to them as 'rules' throughout. Second, I refer to corporate governance as an institution. This might seem beyond question because, as North noted, institutions are the 'rules of the game' (North 1990: 3). However, the introduction of a new governance code should not be viewed as the replacement of one set of written rules by a new set embodied in the code. Jepperson offers the view that institutions are variously 'enabling structures', 'social programs', 'performance scripts' or merely a pattern of behaviour that owes its survival to a 'self-activating social process' (Jepperson 1991: 145), which drive behaviours inside organisations, even when people are unaware of it. This second definition fits well with the reality of legacy corporate governance practice with its blend of formal and informal, public and private behaviours. The introduction of a new code may therefore be viewed as the imposition of a new institution on the formal *and informal* institutions which constitute the legacy governance practice in operation within corporations.



The core of my theory concerns the decision-making mechanisms used by corporations to frame their governance processes and to decide whether and how to comply with the governance code. I will establish three rival hypothesis or alternative explanations for explaining corporate decision-making. In outline I label the first of these ‘Power’ – the use of elite power and accompanying sense of impunity on the part of corporate leadership to use the code to its own ends whether by rejecting parts of the code or misrepresenting its actions through maintaining a distinction between stated compliance and de facto governance. The second I label ‘Efficiency’ – the pursuit by the corporation of economic efficiency in its governance practice which is determined by accounting practices such as cost-benefit analysis to judge whether legacy governance practice should be replaced by new practices. Finally, the third I label ‘Legitimacy’ - the seeking of acceptance of corporate behaviour from external third-party actors. I illustrate these rival explanations in Figure 2.1.

**Figure 2.1: Overview of the three rival explanations for corporate decision-making**



## 2.2 Rival explanations of corporate responses to a new code

To provide possible mechanisms to explain corporations' responses to a governance code I refer first to the literature on soft law business regulation which deals directly with codes of corporate conduct (Abbott and Snidal 2000: 422), and to the literature on the rational choice and organisational schools of neo-institutionalism<sup>25</sup> (Campbell 2004: 9-30, Scott 2014: 30). A third so-called historical school of neo-institutionalism offers no additional explanatory mechanisms but does contain strong arguments for combining the mechanisms which are identified in the other schools as coexisting in a given corporation. I discuss the relevance of this at the end of the section.

### 2.2.1 Corporate power

Voluntary corporate governance codes belong to a wider category of corporate codes of practice known as soft law.<sup>26</sup> In this form of regulation, the strictures of high levels of enforcement typical of traditional or hard law, are relaxed, often because of state incapacity and compliance depends on a voluntary act by the corporation. One particular form<sup>27</sup> of soft law has grown rapidly since the 1990s to address market failures in international trade outside the purview of any one single state: these failures pertaining to issues of sourcing, employment, human rights, product and food standards and environmental protection. The growth in soft law over this period is due to both demand-side and supply-side factors. On the demand side, there has been significant growth in world trade in the past 30 years aided by digital technologies enabling the widespread globalisation and coordination of fragmented supply chains. The number of NGOs or special interest groups acting as regulatory, or norm

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<sup>25</sup> Occasionally other nomenclature is used: rational choice neo-institutionalism in economics is referred to as the 'new institutional economics' and organisational neo-institutionalism is labelled 'sociological institutionalism'.

<sup>26</sup> Soft law has existed since medieval times in the form of the *Lex Mercatoria* which evolved in the 11<sup>th</sup> century to self-regulate inter-state trade lying outside the remit of single-state feudal legal systems such as English Common Law (Toth 2017).

<sup>27</sup> Soft law is also used in inter-state governance agreements eg: NATO, SALT, GATT, CPNM, WTO, NAFTA, WTO, and the ITO (Abbott and Snidal 2009).

entrepreneurs prepared to lobby for causes and to champion particular issues of concern has also grown rapidly<sup>28</sup> (Keck and Sikkink 1998:11). On the supply-side, one reason for the profusion of soft law is its flexibility of form<sup>29</sup> making it suitable for a wide range of treaties, codes of practice and other arrangements.

The catalyst for the origination of soft law is like that of hard law as set out by Joseph Stigler (1971): the precursor is the identification of a market failure; disadvantaged agents or bystanders make common cause and lobby institutions to impose constraints on firms participating in the market in question. In practice, much soft law comes about by some form of coordinated action<sup>28</sup> by NGOs, states or even corporations themselves. Abbott and Snidal refer to this as the ‘Governance Triangle’ (2009: Ch 2), and also provide evidence that the ongoing success of soft law depends crucially on continued collaboration across the governance triangle (2000: 53-57). The role of non-state actors in the success of international labour standards is underlined by Toffel, Short and Oullet (2015) who conclude that the adherence to voluntary codes of practice must be continually reinforced by alliances between states, civil society and firms. However, NGOs tend to specialize in their interests and may not be effective at promoting a code of practice with a wide remit, or at ensuring that codes remain fit for purpose and continue to bring about the desired changes in change in actor behaviour (Ronit and Schneider 1999: 245, Abbott and Snidal 2009). Instead of hard law style enforcement, direct action may frequently be required, for example: public naming and shaming by NGOs (Seidman 2007, Vogel and Kagan 2002); a free local press prepared to

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<sup>28</sup> The number of NGOs quadrupled from c1000 in 1994 to c4100 in 2015, a CAGR of c7% (Willets 1996:38).

<sup>29</sup> Abbott and colleagues define the characteristics of legal forms along three dimensions: obligation, precision, and delegation. They attribute most of the possible permutations on these dimensions to soft law so that hard law is rather the exceptional case (Abbott, Keohane, Moravcsik, Slaughter and Snidal 2000: 404). This freedom over definition provides huge flexibility to policymakers to adapt a regulatory solution to a given purpose (Abbott and Snidal 2000: 422). Abbott and Snidal assign a 3-level scale to each dimension giving 27 cells of which 25 are considered versions of soft law (2000: 422).

lobby (Soule 2009); or active inspections of corporations' premises and supply chains (Toffel, Short and Ouellet, 2015).

Broude and Shereshevsky consider the issue of compliance with soft law in an international context. Although, by definition, soft law is not formally binding, as far as there being '*a state of conformity or identity between an actor's behaviour and a specified rule*' is concerned, compliance with soft law surely exists, and when compliance is viewed as a choice, adherence to soft law lends itself to rational and behavioural analysis (Broude and Shereshevsky 2021: §5.1).

As to why actors might want to conform with soft law once established for whatever reason<sup>30</sup>, Broude and Shereshevsky provide some tentative explanations<sup>31</sup> but assert that such explanations must be contingent on the specific application of soft law and the identities of the actors under scrutiny – especially so for forms of soft law that make no claim to reflect existing hard law (ibid: §5.3).

The key driver of corporate behaviour is identified in the literature as residing in the transaction costs associated with research, development, implementation, monitoring and enforcement, which must be offset against the benefits derived from having the new rules in place (Coase 2013 [1960]). In soft law, costs and benefits are asymmetric – benefits are necessarily directed at protection and reparation for disadvantaged groups that are ill-prepared to fund costs,<sup>32</sup> and therefore costs fall disproportionately on corporations resulting in contestation (Stigler 1971). Soft law offers few widespread exogenous benefits or incentives for corporations associated with code compliance with only two exceptions

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<sup>30</sup> Guzman and Meyer provide reasons for why states use soft law (Guzman and Meyer 2010). and use the term International Common Law to characterize the creation of international soft law by international courts and tribunals.

<sup>31</sup> For example: the provision of ready-made solutions in a context of bounded rationality; status quo bias; reputational social inference especially the meeting of other actors' expectations; reducing informational uncertainty; and non-numerical cognitive anchoring.

<sup>32</sup> Typically: protection of vulnerable employees in the supply chain, consumers at risk of faulty products or of exploitation, third parties from pollution, disturbance, infection or loss of amenities or the natural environment from despoliation

identified by Vogel (2005): consumer-oriented corporations which may be able to build brand equity from compliance with a code of practice (for example by emphasising ethical sourcing); and corporations engaged in environmental damage seeking to placate protesters by broadcasting code compliance. Beyond these examples, copious studies have failed to show any clear correlation between soft law code compliance and improved financial performance of firms (Vogel 2005).

Soft law literature offers extensive insight into the types of strategy used by corporates to mitigate or avoid the costs associated with code compliance, here characterised on a spectrum from the more benign to the more malicious. The least malign is reputation management: firms that are able pursue a virtuous reputation in their markets by advertising their compliance with soft law norms, to secure a reputation that is virtuous, financially trustworthy or caring for the environment, as required. In practice this strategy is sometimes referred to in the literature as greening or ‘blue washing’<sup>33</sup> and may have to do more with what firms say about their compliance than with the reality of their behaviour (Vogel 2005, Berliner and Prakash 2015: 116). By contrast, firms may be strategic in their selection of which rules to apply. When confronted with an extensive code of conduct involving many components, corporations may respond by engaging in a selection process in which they refuse to comply with, or ‘shirk’, the most onerous rules and “cherry-pick” others (Berliner and Prakash 2015). In the case of governance, these strategies might apply respectively to constitutive and regulative rules. Such strategies could present well but may leave the code ineffective because important rules may be ignored through undisclosed shirking.

Moving towards a more overt expression of power, some firms may seek to capture the process. Firms effectively compete with government to “capture” the regulatory process

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<sup>33</sup> ‘Bluewashing’ refers to the 2000 Global Compact of the UN which created opportunities for members to pay lip service to the true goals of CSR instead of undertaking substantive but costly changes in their environmental and human rights performance, and is considered a spin on the more familiar term ‘Greenwashing’.

in either its formulation or its de facto interpretation though the need to do this with a voluntary code must surely diminish. Capture can involve exerting instrumental or structural power to influence policy (Fairfield 2012) especially in policy areas not well understood by the public such as governance (Culpepper 2011). Firms may also engage in a social capture process, in which individuals working within regulators and firms collude with each other either to leverage scarce expertise or to guarantee themselves future jobs through the ‘revolving doors’ which separate regulated and regulator. Either way they diminish the efficacy of the regulatory process (Kwak 2013). Taken to an extreme, this framing lends itself to the exploration of strategic options and game theory where there may be clear winners and losers (Potoski and Prakash 2004).

At the most malign end of the spectrum is control. Corporations may participate in the regulatory process so that they can *adopt the coercive powers of the state*, for their own benefit, through anti-competitive behaviour. Stigler (1971) identifies four such strategies in a study of US regulation: some form of cash benefit; limiting entry to potential competitors; influence over substitute and complementary products; and price-fixing.

The process by which corporations develop strategies around compliance with a code of practice is not well articulated in the literature. For example, Poulsen (2014) refers to bounded rationality at work in the diffusion of investment treaties, in an acknowledgement that firms are far from perfect in their approach to strategy formulation. Toffel, Short and Ouellet (2015: S2) review a wide literature in the labour standards arena documenting the partial compliance with codes of practice. However, they conclude that, although much is known about why companies adopt new codes, *‘little is known about the conditions under which they adhere to the espoused norms’*. David Vogel (2005: 35) points out that the large number of factors under consideration, and the operational complexity of the context in

which they are at play, suggest that there is no reason to suppose that there should be a convergence of the strategies employed by different corporations.

However, the motivation for these strategies does appear to be clear: the expression of corporate power to avoid accepting an additional cost burden, whether this be an additional expense or an opportunity cost. This literature on cost avoidance strategies strongly reinforces those aspects of neo-institutional theory which conclude that firms have strategies: seeking to ‘win the game’ (North 1990) however defined; by ‘decoupling’ their reported compliance from reality (Fiss 2012); or evolving internal informal institutions to compete with weak external formal institutions (Helmke and Levitsky 1970).

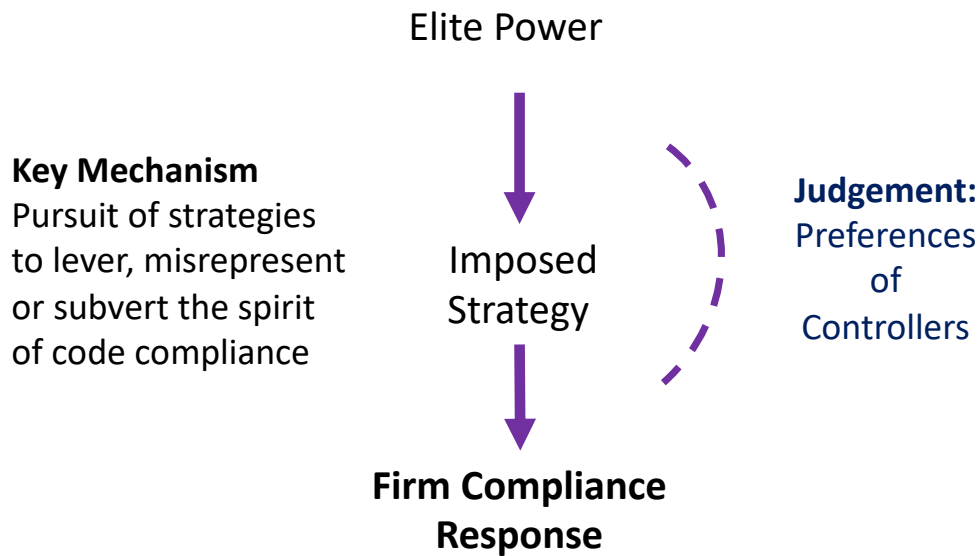
If strategies such as those described exist in relation to soft law codes of practice in the case of international codes of business conduct, it is reasonable to at least hypothesize that similar strategies would be in evidence in the case of a corporate governance code.

I illustrate my first hypothesis in Figure 2.22.<sup>34</sup> In the world of the Power hypothesis, listed firm compliance with the governance code is determined primarily by opportunistically pursuing strategies to subvert, deflect, or otherwise benefit from code compliance, in accordance with the preferred outcomes of controlling shareholders.

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<sup>34</sup> In Figures 2.2 to 2.5 I use a visual nomenclature developed by Judea Pearl (2009, 2019) termed directed acyclic graphs (DAGs) to explain potential causal relationships between a dependent variable - here taken to be a firm’s reported code compliance - and several possible causal factors. These charts do not depict management processes.

**Figure 2.2: Causal framework reflecting elite power and imposed strategies**



Such an expression of power and wider strategizing may very likely constitute a feature of decision-making around compliance in Latin America given Schneider’s description of hierarchical capitalism in HMEs, in particular the casual attitudes towards the enforcement of hard law in the region. It is especially likely if the process of institutional importation and institution-building itself is flawed, and if an equivalent of the governance triangle coalition model is not functioning.

Given Broude and Shereshevsky’s comment that any more positive explanation of compliance with a given piece of soft law will need to be contingent (Broude and Shereshevsky 2021: §5.1), I therefore turn to the institutional literature for further possible explanations more directly appropriate to the institution of on shore corporate governance involving corporations as the affected actors.

### **2.2.2 Economic efficiency**

Rational choice neo-institutionalism evolved as a reaction to what was considered to be the overly descriptive work of neo-classical economists (Campbell 2004: 10) and it is closely related to the so-called New Institutional Economics (Richter 2005). The objective of



this school was to develop a new economic theory of institutions rather than merely to extend orthodox economic theory in relation to multiple institutional contexts (Scott 2014: 30). This new theory was based on the work of three economists: Ronald Coase (2017[1937]), who emphasised the importance of transaction costs as a measure of the efficiency of institutions over markets and as a key input to decision-making; Douglass North (North 1990: 3) who defined institutions as systems of formal and informal rules; and Oliver Williamson (1985, 1991) who extended the market/firm duality to embrace a wider array of institutions and hybrid structures. Other antecedents include Herbert Simon (1978, 1997[1945]), who evolved the notion of ‘bounded rationality’ in the collection and analysis of information; Joseph Schumpeter (1961[1926]) who worked on innovation and its role in development and Richard Nelson and Sidney Winter (1982) for their work on organisational evolution.

North provided the central vision of the institution comprising the following elements: a formal institution or set of formal rules; actors who are subject to those formal rules; a means of enforcement of the formal rules; and crucially an informal institution or array of informal rules that amplify the scope of the formal rules (North 1990). In such an institution, actors are motivated by an instrumental logic to pursue their own self-interests to achieve an equilibrium state or pareto condition in the context of an array of exogenous incentives and sanctions, and to carry out cost-benefit calculations under conditions of bounded rationality (Simon 1997: IV.3), in order to determine their actions (whether these limitations are caused by lack of either information or analytical competence). However, the way in which such a cost-benefit calculation should be made in relation to constitutive rules with political ramifications is not elaborated.

Exogenous incentives and sanctions<sup>35</sup> are seen as the crucial drivers of actor behaviour. According to the model of economic growth developed by Acemoglu, Johnson and Robinson (2005), one role of political institutions is to design economic institutions that in turn set incentives to which rational actors respond. The reason economic actors respond to incentives, according to North (1990), is that they provide opportunities for corporations to reduce their transaction costs, whether by becoming more functionally efficient due to positive incentives, or by avoiding costly sanctions due to non-compliance. Little is said about the nature of this motivational structure, but it is clear that the incentives and sanctions pertaining to any situation and corporation will be contingent on the circumstances so that corporations will experience incentives differently and will make their own decisions about how to respond.

North (1990: 4-5) maintained the distinction that institutions are the rules and organisations are the players. However, actors are not merely subject to institutions. Some authors embrace methodological individualism (Hodgson 2007) to claim that actors can be responsible for creating formal institutions, to advance their own economic self-interests (Coleman 1974: 28-29, Scharpf, 2019 [1997]: 40). Actors also play a key ongoing role in maintaining informal institutions by filling in the gaps left by formal institutions and by bending them to their own purposes when conditions are suitable.

This institutional view of economic efficiency is reinforced in the soft law literature which shows that firms that have group structures or are diversified internationally may achieve efficiency gains from standardising compliance across their business units. Rather than engage deeply with the details of a code in multiple locations, these firms seek economies from adopting a standard approach across all locations; so, for example, that

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<sup>35</sup> Note that I use the term incentives later to refer both to positive incentives and to negative incentives, or sanctions or penalties associated with compliance.

through common procedures and training, staff can experience a similar governance environment wherever they may work in the group (Vogel 2005).

In the context of a new governance code, it is conceivable that some incentives emerge directly<sup>36</sup> because of the new code. It is also reasonable to assume that the introduction of a new code would serve to reframe<sup>37</sup> existing incentives and sanctions already partly in place from the other institutions in the governance ecosystem. Drawing on the literature on corporate governance, incentives and sanctions could come from regulators, stock exchanges and institutional investors and, according to soft law theory, from consumer groups and activist NGOs, depending on industry sector. The introduction of a new governance code provides the opportunity for these actors to renew or reframe their efforts to improve corporate behaviour. As I demonstrated above, soft law theory suggests that there is further potential for collaboration and coalitions between third parties to have more impact on corporations. In sum, the decision to be made by corporations is whether to replace legacy practice with any new practice contained in the code; a decision based on a self-interested cost-benefit assessment of the respective transaction costs. The result of this represents the corporation's compliance response.

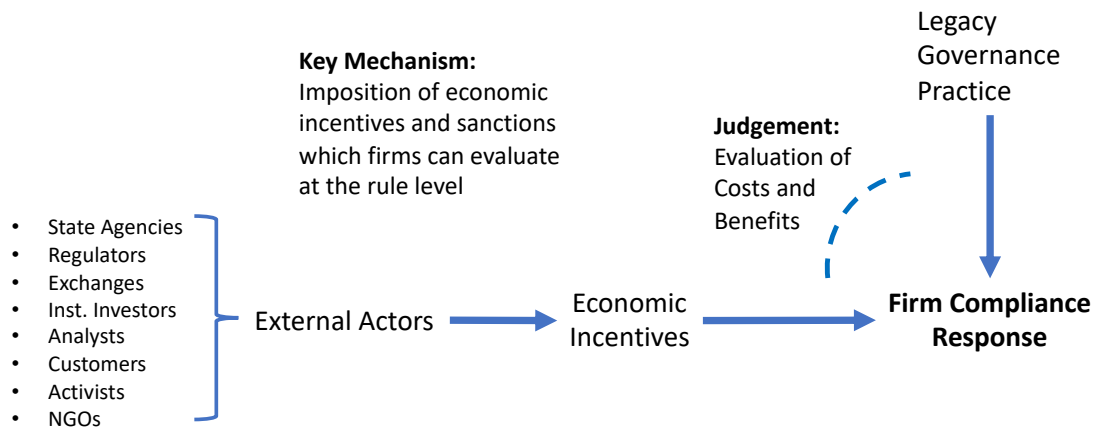
I illustrate my second hypothesis in Figure 2.3. In the world of the Efficiency hypothesis, listed firm compliance with the governance code is mediated by the mechanism of exogenous incentives. It is determined primarily by a judgement about functional efficiency using cost-benefit analysis to weigh the adoption of new rules against the maintenance of existing governance practice.

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<sup>36</sup> Direct incentives could include best practice that management find useful e.g., risk management practices,

<sup>37</sup> Reframed incentives could include invigorated attempts by third parties to affect corporate behaviours eg industry-specific groups such as regulators imposing minimum standards of behaviour, customers exercising buying power, activists protesting environmental abuse; domestic or international stock exchanges imposing behavioural rules; and institutional shareholders being active in influencing boards.

**Figure 2.3: Causal framework reflecting the pursuit of economic efficiency**



The chart shows the core mechanism of the rational choice school: the firm’s compliance response is the pursuit of functional efficiency - a result of a self-interested but bounded rational evaluation of the costs and benefits associated with maintaining legacy governance practice versus adopting new practice in response to exogenous incentives.

The rational choice perspective on the mechanism of change is, however strongly contested by proponents of the organisational school who propose an alternative logic.

### 2.2.3 Legitimacy seeking

Organisational institutionalism emerged from work by Weber and Durkheim and other 20<sup>th</sup>-century organisational theorists (DiMaggio and Powell 1991). From among these I want to highlight four significant contributors. Selznick (1948) developed the concept of institutionalisation, that is how organisations established to achieve a practical purpose become institutions through the construction of common meaning systems. Selznick also concluded from his work with the Tennessee Valley Authority, that organisations are not always rational, while Stinchcombe (1968: 107), who defined institutions as structures in which powerful people are committed to some value or interest. Simon (1978, 1997[1945]) considered organisations to be structures in which the behaviour of individuals is guided through a range of devices including performance programmes and search programmes - pre-

set routines that provide guidance to individuals as to how to act. Finally, Friedland and Alford defined the concept of ‘institutional logics’ - essentially a typology of seven distinct institutional forms of which the corporation was but one example (1991: 248 – 253).<sup>38</sup> Selznick’s Tennessee Valley Authority study (1949) led him to conclude that frequently organisations did not appear to perform according to their mandate but rather served the needs of specific groups who held power or influence over the organisation. Indeed, some organisations responded to outside pressures to alter their initial goals in order to survive.

To explain this phenomenon, organisational institutionalists considered that organisations seek to act appropriately vis-à-vis their cultural environments. This ‘logic of appropriateness’ is central in organisational institutionalism in contrast to the ‘logic of instrumentality’ espoused by the rational choice economists. Campbell notes that organisations adopt whatever practices they believe their institutional environment deems appropriate, *‘regardless of whether these practices increase organisational efficiency or otherwise reduce costs relative to benefits’* (Campbell 2004: 18).

The crucial driver of behaviour underpinning this alternative logic of appropriateness is the notion of ‘the field’. Organisational institutionalists typically operate at a level of abstraction above the individual organisation to include a population of organisations or individuals that participate in a common meaning system referred to as the field (DiMaggio and Powell 1991: 84,85). They observe similarities in the structures across organisations referred to as ‘isomorphism’,<sup>39</sup> ascribing this phenomenon to the view that organisations that share a common field or fields of influence come to conform to culturally appropriate scripts. These scripts serve to determine the appropriateness of the behaviour of each organisation

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<sup>38</sup> The other six being Family, Community, Religion, State, Market and Profession (Thornton, Ocasio and Lounsbury 2012: 72, Table 3.2)

<sup>39</sup> Isomorphism occurs via one of three types of mechanism: mimetic, or copying the practice of other players; normative, or professionalisation throughout the executive ranks; or coercive, because of force (DiMaggio and Powell 1991: 67-70).

and the degree of legitimacy which it accumulates, rather than to outcomes from the instrumental pursuit of self-interest by actors in those organisations. Field structures can be very complex combining multiple entities in hierarchical structures (Scott 2014: 220-258). For example, in one study of corporate environmental practice, Hoffman (2001: 142) identified 12 “occupational communities”<sup>40</sup> that were motivated and able to exert influence.

Organisational institutionalists locate the interaction between the field and the behavioural underpinnings of organisations in two mechanisms: normative processes in which individuals are self-consciously making choices which they know to be in keeping with the institution; and cognitive processes in which what is appropriate depends on taken-for-granted scripts, schema, habits, and constitutive processes which are not fully in the conscious realm (Campbell 2004:17, Scott 2014: 75-80). This latter notion of cognitive constraints on behaviour draws on Kleinian concepts of object relations (DiMaggio and Powell 1991, DiMaggio 1997).

Communication between the field and the organisation is based on the relative power of the participants. Stinchcombe (1968:107,162) considers that the values which define legitimacy are those of the group or individuals who have social power and so legitimacy is bestowed on firms with values and norms preferred by the power holders. Fields are therefore not benign and cooperative arrangements but will directly reflect the interests of the most powerful members of a field (Fligstein 1990: 6,7). Power exercised by firms, rather than by members of a field can result in strategies to thwart external rule providers - organisations may frustrate the implementation of a new set of rules by “decoupling” structure from technical work. This occurs on a spectrum from avoidance of close supervision in a defensive mode, to a more extreme form where the decoupling serves to present a symbolic or

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<sup>40</sup> Hoffman’s Field-Level Communities: Regulatory Agencies, Suppliers, Buyers, Consumers, Financial Institutions, Shareholders, Social Activists, Investors, Insurance Underwriters, Trade Associations, Academic Institutions, Religious Institutions.

ceremonial representation of the desired activity which does not accord with reality and which can be seen as more strategic (Meyer and Rowan 1977: 356, Fiss 2012: 397, Thornton, Ocasio & Lounsbury 2012: 57 - 59).

More recent theorists identify a different process by which legitimacy is formed, which represents an amplification of Searle's notion of collective intentionality. Legitimacy is framed not as an asset that is owned by the organisation or institution in question, nor as a gift bestowed on a corporation by a benefactor, but is a judgement made by agents (Bitektine and Haack 2015: 50). The formation of such a judgement occurs at two distinct levels: individual-level propriety and collective-level validity (Johnson, Dowd and Ridgeway 2006, Tost 2011, Zelditch 2011). The first component, propriety, represents an *evaluator's* approval of the organisation, its actions, or its practices as desirable and appropriate and may be made on instrumental relational or moral considerations (Johnson et al. 2006, Tost 2011). The second component, validity, refers to '*the extent to which there appears to be a general consensus within a collectivity that the entity is appropriate for its social context*' (Tost 2011: 689). Thus, propriety is an individual *evaluator's* own judgment of social acceptability - a *microlevel* construct - whereas validity represents a collective consensus about legitimacy that is present at some higher *macrolevel*, such as the group, organisation, organisational field, or society and is formed through the contributions of *judgement validators*.

In this model, individual evaluators form their propriety judgements based on their own evaluation and perceptions of the information available to them about the institution itself, while they form validity beliefs based on their perceptions of macrolevel validity, or on the consensus opinion that exists at the macro level. The construction of validity through majority opinion is one of the primary mechanisms through which collective legitimacy judgements are made at the society, field, or organisational level (Bitektine and Haack 2015: 51). Validity may be affected by various critical sources, or *judgement validators*, such as the

media, experts, government, or the judiciary who possess potentially conflicting views from evaluators and provide a consistent cue to evaluators (ibid 2015: 52).

In the context of a new governance code, the fields of powerful influencers could include other family members and their socio-political network, sector leaders and business associations, direct investors, shared board members,<sup>41</sup> and executives from the wider corporation or the firm's supply chain. In this case, the new code is a provocation to the decision-making group (DMG) in the corporation, perhaps especially regarding constitutive rules introducing third parties into corporate processes, to change legacy practice to the new practice. This is based on a judgement of the relative acceptability of the new and legacy governance practice to the relevant field of influencers and the result represents the corporation's compliance response.

I illustrate my third hypothesis in Figure 2.4. In the world of the Legitimacy hypothesis, listed firm compliance with the governance code is determined primarily by the mechanism of legitimacy-bestowal by the relevant fields of powerful influencers,<sup>42</sup> in which firms judge how best to trade compliance for the legitimacy they seek.

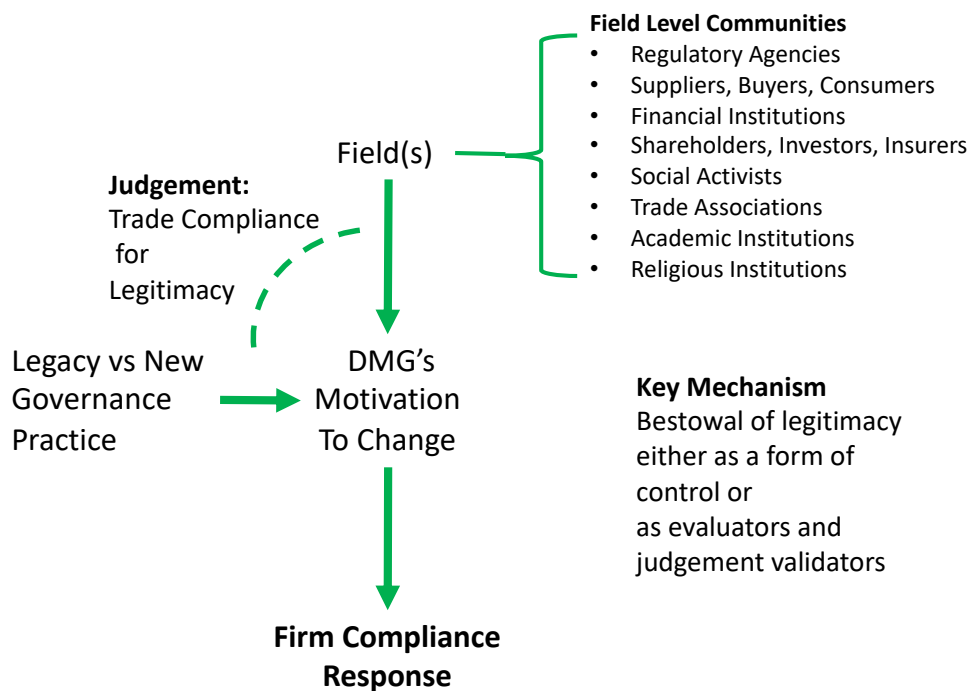
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<sup>41</sup> Shared board membership or interlock varies significantly between countries (Cárdenas 2016: 346).

<sup>42</sup> Here as a starting hypothesis shown as Hoffman's 12 Field Level Communities (Hoffman 2001: 142).



**Figure 2.4: Causal framework reflecting the pursuit of legitimacy**



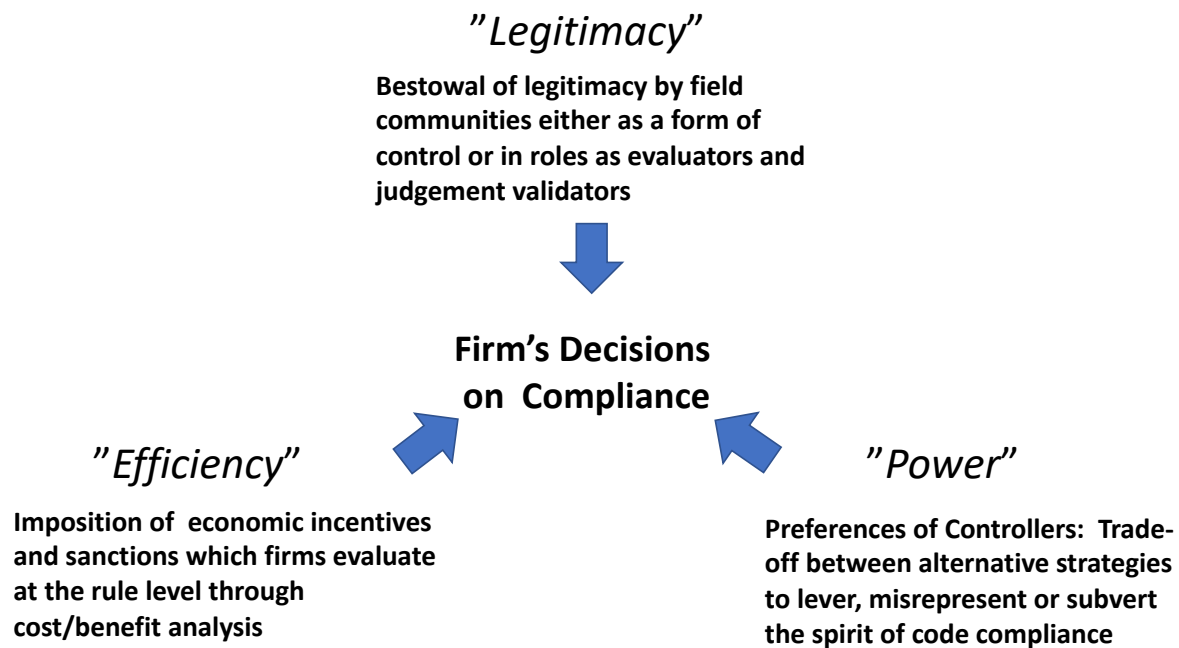
Adoption of the new code depends on the DMG's motivation to change from legacy practice to new practice, which in turn is based on a constrained-choice judgement of the relative acceptability and legitimacy of each option, as conferred by powerful influencers in the relevant fields. I have not included the more elaborate multi-level mechanisms proposed by Bitektine and Haack (2015) but will explore these in the research.

I have identified three different mechanisms for framing how corporations might respond to a new governance code: the expression of elite power towards compliance manifest in a range of strategies aimed variously at deflection or subversion of the code imposition process and at cost avoidance; pursuit of efficiency based on a rational choice, instrumental and self-interested evaluation of costs and benefits; and pursuit of legitimacy based on a judgement about the relative appropriateness of governance behaviours as perceived by the relevant fields of powerful influencers.

### 2.3 A theoretical model to explain corporate decision-making.

I combine here the three causal factors identified in §2.2 into a single causal model.

Figure 2.5: Causal model integrating all three rival mechanisms.



The chart shows, in summary form, the three mechanisms potentially in play.

Clockwise from bottom right are the expression of elite power to subvert or distort the code imposition process shown above in Figure 2.2; the pursuit of economic efficiency shown in Figure 2.3; and the pursuit of legitimacy bestowed by field communities for acceptable behaviour shown in Figure 2.4.

The role of this model is to provide a detailed account of each decision-making mechanism and offers three benefits: first, it clearly sets out the three alternative decision-making models derived from the literature, and puts them potentially in play in any given corporation; second, it provides context for the roles played by third parties and members of fields in determining corporate compliance outcomes whether working individually or in coalition; lastly and crucially, it makes explicit the assumptions being made about the nature of potential causality in each model.

In addition to the mechanisms described above, there are three further observations concerning both ontology and epistemology that although they relate to the model as it is applied, are best discussed under the topic of methodology. In brief, these are first, that the three mechanisms described above may be present in each corporation, to differing degrees and deployed in different decision-making arena; second, across the population of corporations, that there is likely to be equifinality even if they are deploying the same decision-making mechanism regarding code compliance because their contacts with outside actors, and so any incentives they experience, will differ; and third, that any differences in outcomes between corporations are likely to be best observed by scrutinizing those parts of the code that are most contested. I will expand on each of these points in Chapter 4, §4.2.

In the next section, I will define the primary research question and key hypotheses to frame the objectives for a research programme set out in the next chapter.

## **2.4 The research question**

The key research question<sup>43</sup> I will explore is: how do listed corporations make decisions regarding their response to a voluntary corporate governance code?

To address this question, my intended approach is to form a judgement about the role played by the three rival mechanisms set out above. I will do this by establishing a clearly stated hypothesis to represent each mechanism, collecting evidence relevant to corporate compliance and decision-making, testing this evidence for its plausibility in the “world” implied by each hypothesis, then forming a judgement about the relative likelihood of that

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<sup>43</sup> Note that this question is posed at the ‘meso’ level – I intend to provide an explanation for corporate behaviour at the level of the individual corporation so my response will not be purely ‘macro’ – a general explanation for the overall stance of corporations to a governance code, similarly, I will not be providing a ‘micro’ explanation of individuals’ behaviours of corporations’ responses to specific rules comprising the code.

evidence emerging under one or the other hypothesis. This process is known as Bayesian Inference,<sup>44</sup> which I will describe in detail in Chapter 4.

I set out the rival hypotheses for corporate decision-making below. In each case I have provided an imaginative description of the possible context within a corporation for such a decision-making approach to be sustained, based on my reading of the literature. In each case, the chosen decision-making approach to governance will have implications for the predominant values in the firm, how controlling shareholders and the board behave, how employees are involved in the process, and how the firm conducts its relationships with outsiders. I will not be explicitly testing these world views (in any case, they are likely to change throughout the research), but will be using them to *test the likelihood of the emergence of the evidence* that I discover in my research. I provide them here only for illustrative purposes.

The first hypothesis reflects a causal model based on the exercise of corporate power through the mechanism of imposed strategizing, shown in Figure 2.2:

**The Power hypothesis. A firm’s compliance with the governance code is determined primarily by an expression of power by controllers, in which the board opportunistically pursues strategies to subvert, deflect, or otherwise benefit from its reported compliance with the code.**

Illustration<sup>45</sup> of the imagined ‘world’ of the power hypothesis: *firms will perceive the governance code to be source of external intrusion into their affairs as well as representing an additional cost. The decision-makers are likely to be a small group dominated by major shareholders and directors with little delegated authority. Firms will experience ‘constrained*

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<sup>44</sup> Bayesian Inference focuses on the evidence – it tests the likelihood of evidence emerging under contrasting world views. It does not seek to test hypotheses directly nor does it use a null hypothesis as a foil.

<sup>45</sup> Note that the three ‘world’ descriptions given here are for illustration only – I do not use these texts as templates for hypothesis testing. In the case analysis I provide in Chapter 6, I draw on specific aspects of the case in question to frame the world of each hypothesis that are the most relevant in each case.

choices' (cf 'bounded rationality') but will not seek to improve their acuity since they will consider they have a very good understanding of what counts- their control of the business. They will be especially sensitive to constitutive rules and will resist the inclusion of third parties in their governance processes which they regard as a private matter. Firms may be very sensitive to the opportunity costs associated with third part scrutiny – that is they will not be as free to pursue self-interested or fraudulent activities as in the past, and this will encourage firmer resistance to constitutive compliance. Firms will seek to reduce the impact of the intrusion of new actors on the business while being aware of possible presentational opportunities for the firm arising from apparent compliance with the code. Firms may have been inclined to exert influence to alter the code when it was launched and may continue to do so as changes are made - whether in terms of its method of implementation or how it is monitored and may also be keen for executives to be on working groups. They may seek a gain in political or commercial capital from adopting a strategic stance towards the code, whether benign or malicious, and any new practices may not be embedded in the wider values or practice of the firm. There may be large discrepancies between the spirit of reported compliance and actual governance behaviour. Firms will seek to present their governance in a favourable manner perhaps disguising their non-compliance or over-favourably misrepresenting their compliance. Decision-makers will be guarded towards outsiders unless they come from a small circle of previous contacts but may hire ex regulators to promote their interests. They will be reluctant to articulate in detail their stance towards the code and although they will be conscious that they have adopted a distinct strategy with clear objectives this may not be disclosed in interviews. It is very unlikely that decision-makers will be reflexive in their approach to governance, will be reluctant to involve employees in new compliance processes and will not promote new governance

*practice as a positive cultural development. They may be aware of third parties and field members but only as competitors or collaborators, not as influencers or as role models.*

The second hypothesis reflects the instrumental causal model derived from rational choice neo-institutionalism shown in Figure 2.3:

**The Efficiency hypothesis. A firm's compliance with the governance code is driven by the board's pursuit of economic efficiency. This is based on cost benefit-analyses comparing the maintenance of existing governance practice with the adoption of new rules, in relation to any economic incentives or sanctions established by external agents.**

*Illustration of the imagined 'world' of the Efficiency hypothesis: firms will be open-minded about compliance with specific rules and will seek to find the functionally most cost-effective approach to compliance. Firms will carry out an analysis comparing the benefits of compliance with the costs of existing practice and the transaction costs of changing practice. If part of a group, firms will be likely to adopt streamlined processes that reduce operational complexity. Governance functions may be removed entirely from subsidiaries in the interests of cost-effectiveness and located elsewhere in controlling companies. Executives will be able to describe the firm's approach to cost-benefit evaluations. Examples will be cited in which new governance practice that carries an attractive cost-benefit profile has been complied with and vice versa, and some new practice may be reversed. Evidence for keeping decisions about whether to comply or not under constant review will be available, and a rationale will be available for any compliance decisions that might have been reversed. In this sense, decision-makers will exhibit reflexivity but not of the 'double loop' form to challenge their underlying economic paradigm. Decision-makers may be widely dispersed with delegated authority and will feel confident in their ability to make such judgements but may struggle with 'bounded rationality'. This may make some compliance decisions either hesitant because of uncertainty in the cost-benefit outcome, volatile because new or better*

*information might come to light or delayed while evaluations are carried out to the required accuracy. The firm's stance on outsiders (INEDS, board reviewers, and auditors) will be positive with a well-articulated view of the value they bring net of their associated costs. They will be keen to socialise the economic efficiency of governance and will be open to including employees in the process if they are suitably trained and will frame this as the promotion of a commercial culture. There will be a plan for ongoing implementation of compliance decisions. Decision-makers will be alert to the actions of third parties and may monitor lobbying activities aimed at promoting compliance, especially if these imply additional costs for the firm.*

The third hypothesis reflects a causal model derived from organisational neo-institutionalism shown in Figure 2.4:

**The Legitimacy hypothesis. A firm's compliance with the governance code is determined primarily by the board's pursuit of legitimacy of its governance practice as indicated by the degree of acceptability of the firm's governance behaviours shown amongst the relevant communities of powerful external influencers.**

*Illustration of the imagined 'world' of the Legitimacy hypothesis: firms will prefer to carry on doing what they have always done but will change their practice when the decision-makers consider that the prevailing normative regime in the firm's relevant business community has shifted. The relevant community or field could include any business group of which it is part, its associated partners and supply chain, its financiers, its director and INED group which might be shared with other firms, or actors in wider society. The decision-makers may be a small group dominated by major shareholders and directors with little delegated authority or they may be widely distributed in a matrix of responsibilities. Decision-makers will consider they have a very good understanding of what counts: the values implicit in their business relationship, but they will be reflexive in their approach and*

*may well exhibit 'double loop' reflexivity when important members of their field demonstrate new interests in governance. Firms may be cautious in making changes and will consult with the members of their field and so are unlikely to be first movers particularly in areas of the code that are more contentious; for example, those representing constitutive practice. Decision-makers may still take a cautious stance regarding professional outsiders and will prefer providers with experience in the firm's fields. They will be aware of governance practice in certain other firms, especially if sharing the same fields and may confer with other executives. They will be keen to include employees in the new governance processes, will recognise the cultural implications of compliance with constitutive rules and may espouse a principle of maximum compliance with the code. Decision-makers will be sensitive to the actions and announcements of members of their field, but they will not pay similar attention to third party influencers or lobbyists unless they are seen to have influence over key parties.*

The three rival hypotheses are intended to be mutually exclusive and exhaustive;<sup>46</sup> mutually exclusive because it is not possible for more than one hypothesis to be the *primary* determinant of the compliance behaviour of any given situation, and exhaustive because they cover all the possible options, given the extent of the literature review. Should new or modified hypotheses emerge during the research, I will incorporate them as appropriate into my approach.

In Chapter 3 I will set out my rationale for choosing Peru as a country case study, and in Chapter 4 I will define my methodology for exploring corporate decision-making in Peru, describe the available data, and describe how I have used Bayesian Inference as an overarching methodology to explore these hypotheses.

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<sup>46</sup> This three-part set of possible mechanisms is consistent with other frameworks developed for example by Mahoney (2000: 517) to describe rival mechanisms in institutional path dependency, and by Bennett (2013: 473) in a typology of theoretical approaches to international relations.



## Chapter 3 Country selection and context

### 3.1 Introduction

To test the theory presented in the previous chapter, I have selected the case of a new voluntary corporate governance code introduced into the listed corporate sector in Peru in 2014. This choice did not come about from a reductive analysis of the countries in the region, but from two insights that combine to position Peru as a broadly representative example of the other countries in the region that launched such codes, and also as an especially challenging and informationally rich<sup>47</sup> country case for the introduction of a corporate governance code.

I will first set out the case for my selection of Peru as a sound choice as a country case study, and then set the context for my study: the case for reform of corporate governance in Peru; the process of implementation of the code; and the challenges the code presented for corporations and institutions in Peru.

### 3.2 The case for Peru as country case-study

Peru is in several ways very typical of the seven countries in the region that launched governance codes in the period 1999 to 2014<sup>48</sup> in relation to the ownership structure, financing and legal context of listed corporations and so is a reasonably representative candidate for a case-study. In all the seven countries, to varying degrees, stock markets play a relatively small role in corporate fund-raising and are relatively small both as regards market capitalization and trading turnover as a proportion of GDP when compared with those in the G7 and prominent Asian economies ([de la Torre, Guzzi and Schmuckler 2008: 126](#)). Rather, ownership of business assets is dominated by families often with long histories

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<sup>47</sup> As I will describe in Chapter 4, Bayesian Inference requires that case studies should be rich sources of information rather than strictly representative or not, of a central characteristic.

<sup>48</sup> Mexico in 1999, Brazil in 2000, Colombia, Costa Rica and Argentina in 2007, Chile in 2012 ([OECD 2016 \(c\)](#))

(Monsalve 2016) even in the listed sector. In such businesses, family members not only dominate corporate boards, but they frequently also serve as managers, and so the principal/agent problem identified as one of the driving factors for introducing corporate governance codes in the UK and the US is not a pressing issue (Capaul 2003, Cieply 2013). Furthermore, Peru, along with its neighbours in the region, has a civil law legislature in contrast to the common law legislatures of the UK and the US which, as Guzman and Meyer show, are more attuned to the notion of soft law (2010).

Beyond its representativeness of the group of seven countries, Peru provides an especially challenging context in which to consider the implementation of a voluntary governance code because of the particularly exclusionary nature of Peruvian family ownership and control of corporations is manifest in the wider society (Crabtree and Durand 2017). The exclusionary nature of capitalism in Peru is underscored by the, until quite recently, 20 years of uninterrupted growth in the formal economy (Velarde 2019) due in no small part to significant institutional development in the macro-economy to the exclusion of equivalent development in social institutions (Wise 2003). Peru's society shares many of the societal characteristics of countries in the region with, by developed economy metrics, high levels of informality, inequality and, depending on the history, varying degrees of racial discrimination. However, Peruvian society stands out from the other countries in the group as being especially divided based on race (Drinot 2006:19) with just six percent of the population identifying as 'white' (INEI 2017:220), along with the highest level of informal working in the region and an 'absent state' in rural areas (O'Donnell 1993). This might imply that any attempt to bring more transparency to corporate governance in the interests of the wider society might be resisted because of a perception of otherness on the part of the privileged minority towards its mestizo and indigenous fellow citizens. Peru also has particularly high level of corruption because of collusion between vested corporate interests

and corrupt government officials at national, federal, and local levels. So culturally endemic is corruption in Peru (Quiroz 2008, Diego 2013) that it was chosen by Odebrecht to be their hub for its fraudulent subversion of public procurement outside of Brazil (Durand 2018: 108). Any hope that the mere introduction of voluntary procedures into corporate governance might encourage incumbents to give up any lucrative arrangements they might have would appear to be naïve.

Against this unfavourable context for the introduction of a voluntary governance code, Peru has demonstrably the most poorly perceived corporate governance at least compared to its partners in the Pacific Alliance (EY/BVL 2016) with whom it has shared an integrated stock exchange<sup>49</sup> since 2011. Yet curiously Peru appeared to be ambivalent about adopting a full voluntary code by being the only country to introduce the softer option of Principles in 2002 which did not involve obligatory reporting, yet when the authorities decided to introduce the 2014 code, they adopted the most ambitious targets for governance reform of the entire group (SMV 2013, OECD 2016 (c): 19, 46 – 56).

Peru is therefore both representative of the countries in the region because of the nature of its capital markets, corporate ownership and legal system, and yet presents a challenging context for a code introduction because of exclusionary nature of its corporate sector to the detriment of the rest of Peruvian society which remains disenfranchised. Other countries would not have served as well as Peru as case studies: in terms of GDP, there is a very large difference across the seven countries.<sup>50</sup> Brazil and Mexico are relatively large at three times their closest neighbour, Argentina, and Costa Rica relatively very small at one quarter its nearest neighbour, Peru, and so these three are somewhat atypical of the group of seven. Any one of the other countries, Argentina, Colombia, or Chile could have been

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<sup>49</sup> Mercado Integrado Latinoamericano (MILA)

<sup>50</sup> In 2018 the country GDPs in US\$bn were Brazil: 2,081, Mexico: 1,661, Argentina: 641, Chile: 359, Colombia: 334, Peru: 239, Costa Rica: 64. IMF: 2018: <https://www.imf.org/external/pubs/ft/weo/2018/>

representative of the central group as regards the scale of their GDPs but without the extreme conditions of economic success coupled with exclusivity, inequality, and racism that are present in Peru.

I will expand on each of these characteristics in the following sections which follow a narrative of the case for governance reform, the launch of the code, and then the challenges for adoption of the new code by listed corporations.

### **3.3 There was a strong case for reform of corporate governance in Peru**

While the OECD was acting as norm entrepreneur to encourage seven countries in the region to adopt voluntary governance codes, there was a strong case for the reform of corporate governance in Peru. This was evident from the poor perception by financial markets of corporate governance in Peru, but also from two pernicious effects of such poor governance – the social inequality that persisted because the bulk of the population were excluded from productive wealth-generation and the corrosive effect of a culture of corruption on confidence in public institutions, in which culture corporations played an important role.

Although Peru was recognised as a successful ‘turnaround’ state in the 1990s (Wise 2003: 8) and had, until the COVID-19 epidemic, achieved 20 years of uninterrupted economic growth<sup>51</sup> (Velarde 2019), corporate governance in the country was still quite recently perceived by finance professionals to be the poorest amongst its partners in the Pacific Alliance<sup>52</sup>. In 2014 EY, a financial audit and advisory firm, and the Lima stock exchange (BVL) established an annual survey<sup>53</sup> of financial market professionals to evaluate their opinions on a range of financial market-related issues including the question of

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<sup>51</sup> Peru’s average annual growth in GDP of 4.77%, from 2000 to 2019 prior to the economic impact of COVID-19 (<https://www.macrotrends.net/countries/PER/peru/gdp-growth-rate>)

<sup>52</sup> Chile, Colombia and Mexico

<sup>53</sup> *La Voz del Mercado*

corporate governance. In 2016, EY and BVL carried out a comparative evaluation of the state of corporate governance in the four countries comprising the Pacific Alliance based on three years' results. In all, they collected 2,649 comments from 785 respondents (EY/BVL 2016: 8). Only 12% of respondents considered corporate governance in Peru to be 'Excellent or Very Good' compared with 54% for Chile, 26% for Colombia and 23% for Mexico.

Such poor corporate governance has historic roots. Monsalve provides a historic context to the development of Peruvian corporations and shows how the family business groups have evolved their governance practice to ensure their own survival (Monsalve 2016).

In the first period that Monsalve covers, 1896 to 1960 (Monsalve 2016: 239 - 242), large family businesses emerged as commercial enterprises founded by landholding families who were engaged in commercial land-related activities: agro-industry, mining, real estate and finance. This period established the tendency towards horizontal diversification. Governance was characterised by various features: a 'señoral' style of leadership; patriarchal and centralised decision-making about investments; direct engagement in politics as a means of securing concessions; sharing of financial resources within the group, management through family or quasi-kin relationships and a practice of companies and assets being passed to subsequent generations.

The second period, 1960 to 1990, (Monsalve 2016: 243 - 245), began with a military coup which gave the state a central role in the economy – namely, to address a turbulent macro-economic environment - but also led to hyperinflation and internal pressures from the actions of the Shining Path guerrilla group. Corporate governance of these economic groups maintained much of the central control and family/quasi-kin domination of the previous era, but some innovations were introduced. Holding companies with pyramidal structures became common, to both reduce finance costs and to occlude ownership while maintaining control of increased horizontal diversifications, which were made in line with prevailing government

policies. Other innovations included: the securing of dominant market shares in chosen sectors as a means of influencing government decision-making: direct control of financial firms to provide liquidity and to expand social networks (Monsalve notes 16 financial institutions owned by the leading family economic groups); gradual professionalisation of management; and the introduction of outside shareholders despite the maintenance of family control.

The third period, 1990 – 2010, (Monsalve 2016: 245 - 252), is marked by new neo-liberal policies introduced by President Fujimori in response to the Washington Consensus. Fujimori introduced structural reforms with several aims: to reduce the state's direct involvement in the economy through privatization of state-owned firms; to control inflation by liberalising prices and the exchange rate; and to strengthen financial institutions including the taxation ministry (SUNAT), the Ministry of Economy and Finance (MEF) and the regulator of the financial sector (SBS). Although family-owned economic groups supported these reforms, the early beneficiaries were foreign-owned firms which were able to take advantage of privatisations and invest directly in heavily exporting sectors amounting to what Fujimori described as a reconquest a partial takeover of the Peruvian economy (Durand 2007: 57). Several of the family groups were made bankrupt (including the Galski, Lucioni, Nicolini, Picasso Salinas, and Wiese family groups), some were taken over by foreign firms and others were reduced in size. In response, several business groups such as Benavides, Brescia and Ferreyros and Graña y Montero have internationalised through acquisition or through forming alliances with foreign MNCs. New groups have emerged such as the Rodriguez family from the Gloria group, the Añaño family with the AJE group, the Belmont family of Belcorp and Yambal and the Rodriguez Pastor brothers from the Interbank group. Some of these new family groups still tend to choose sectors which are not competed by MNCs but are less committed to the strategy of internal financial subsidiaries.

The ownership of registered corporations is now heavily concentrated, and the remaining Peruvian corporations are owned and controlled by a very few families. The 233 entities listed on the stock exchange in 2014, when the new code was launched, represent the largest firms in Peru with combined capital value equivalent to 44% of Peruvian GDP. Of these, 179 were parts of 42 business groups owning over 500 subsidiary firms including three of the top four banks, the two largest insurers and two of the (then) five pension funds. And of these groups, 19 were under Peruvian ownership and 23 foreign controlled (OECD 2015:88). In 2017, just eight Peruvian families<sup>54</sup> controlled business groups comprising 37 firms, which dominated approximately 90% of the Lima stock market capitalization and share trading (author's analysis of BVL data, Linares 2018).

Schneider has characterised the current form of capitalism that emerged in Peru during the 20<sup>th</sup> century as comprising a hierarchical market economy (HME) so as to distinguish it from previously defined varieties of capitalism (Hall and Soskice 2001).<sup>55</sup> HMEs are considered to have several defining characteristics, including horizontally diversified business groups to hedge external risks, located in sectors where political leverage could be used to secure market dominance and therefore greater profitability, with in house financial services to be independent of outside influence; and with family members both on the board representing their ownership interest, but also directly engaged in management roles. HMEs also provide corporations with several complementarities including a large unskilled and disorganised workforce (Schneider 2013).

This description of how capitalism operates in Peru underscores the relationship between corporate governance by and for the few, at the exclusion of the many. Durand considers Peruvian capitalism to go beyond even Schneider's hierarchical capitalism and

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<sup>54</sup> Brescia – BBVA; Rodriguez Pastor – Grupo Intercorp; Rodriguez – Grupo Gloria; Romero – Grupo Credicorp; Hochschild – Grupo Hochschild; Benavides – Grupo Buenaventura; Belmont Graña – Belcorp.

<sup>55</sup> Liberal market economies (UK and US) and coordinated market economies (Europe). Since 2001, other varieties describing Asian capitalism have also emerged.

*'reflects a particular social form of hierarchy ....and adds a further aspect, that based on exclusion'* (Crabtree and Durand 2017: 53).

Peru is somewhat unique in Latin America in the extent to which it exhibits a very deeply divided society despite having a growing economy and functioning democracy. Such inequality has historic origins; Miller notes that an abiding feature of the Peruvian economy since the discovery and exploitation of guano in the 19<sup>th</sup> century has been its high degree of personal and regional inequality (Miller 1999: 130). Wealth and opportunity in Peruvian society are as a result very unevenly distributed, with the GINI coefficient for Peru high at 42.4<sup>56</sup> in 2018. In practice perhaps two-thirds of the working population work informally in low productivity settings with little access to state services and with no pension. There are many causes of informality but one study by the Central Bank of Peru found that the higher level of informality in Peru compared with Chile was due to institutional factors including law and order, business regulatory freedom and socio-demographic conditions which were all more advanced in Chile (Loayza 2007:11 - 19). It is not necessarily the case that informality equates to low earnings, some informal entrepreneurs no doubt have high earnings, but on average this is certainly the case. High productivity wealth creation is restricted to a very small proportion of the population working in the formal economy and in sectors such as mining, financial services, energy, and ICT which involve only 15% of the population. Productivity *per employee* measured as gross value added is approximately 200 times greater in these top four sectors than in the services and agricultural sectors, which comprise 80% of the population (OECD 2016 Vol 3).

Inequality is also not randomly distributed; it is closely related both to ethnicity - only 6% of the population is defined as 'white' (Instituto Nacional de Estadística e Informática

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<sup>56</sup> Source: <https://datos.bancomundial.org/indicador/SI.POV.GINI?locations=PE>  
Peru's GINI coefficient has been declining due to cash transfers to the extreme poor, not through improved productivity or empowerment (Gaentzsch 2018).



INEI 2017: 220) - and indigeneity. Being 'non-white' correlates negatively with most measures of quality of life viz duration and quality of schooling, level of literacy, access to health insurance, access to credit, family size and overall earnings (Torero, Saavedra, Ñopo and Escopal 2003: 9, INEI 2018: 225). Inequality is compounded by lack of consistent state presence throughout the country - the 'absent state' - which denies large populations the provision of essential state services, thereby exacerbating the inequality referred to above (O'Donnell 1993). The difficulty individuals face in overcoming these obstacles is compounded by limitations of language - 17.4% of Peruvians do not speak Spanish in favour of Indigenous languages. The racism implied by these observations is a crucial factor in Peru and '*as a normalised idea and behaviour, is central to the exclusionary character of nation-building in Peru*' (Drinot 2006:19).

Corruption is endemic in Peru particularly regarding state institutions<sup>57</sup> and the public procurement of commercial services.<sup>58</sup> Quiroz studied corruption in Peru through seven epochs from 1750 to 2000 and found corruption to be very prevalent in every period (Quiroz 2008). His definition of corruption is rooted in the notion that at least one of the participants in any corrupt transaction will be a public official,<sup>59</sup> but corporations are active partners with government at all levels, and so any attempt to bring transparency and third-party scrutiny into corporations' potentially corrupt activities should be beneficial. Quiroz estimates the financial costs of corruption at between 3% and 4% of GDP and the direct loss, diversion, or misallocation of funds to be between 30% and 40% of public funds between 1820 and 2000

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<sup>57</sup> In 2014, Peru was rated 62<sup>nd</sup> of 99 countries in the World Justice Project Law Index, 79<sup>th</sup> for the perception of corruption in the executive, judiciary, and legislative branches, and 83<sup>rd</sup> for the weakness of the civil justice systems respectively (WJP 2014: 130). Latinobarómetro report: those most involved in acts of corruption were: Parliamentarians 65%, judges and magistrates 63%, the President and his team 60%, local government 46%, police 49, public employees 30, business leaders 30, tax officials 29, religious leaders 19%, various families 12% (Latinobarómetro 2021: 84).

<sup>58</sup> Recently, for example, Lava Jato and also the Construction Club

<sup>59</sup> '*...the misuse of political-bureaucratic power by cliques of public officials, colluding with other self-seeking interests, to obtain economic or political gain inimical to societal development objectives, through the misappropriation of public resources and the distortion of policies and institutions*' (Quiroz 2008: 2).

(Quiroz 2008: 432). However, the equally huge indirect cost, which is more difficult to quantify, is the damage caused to key institutions that facilitate stability and investment known as *institutional costs*, and the resulting opportunity cost of lost economic growth and development.

Institutional theorists provide the insight that because institutional development during the Fujimori era was so narrow - the so-called *Islands of Efficiency* (Crabtree and Durand 2017: 87) - the resulting technocracy was not sufficiently institutionalized nor large enough to provide career development. Experts became dependent on the private sector for career moves; the so-called 'revolving door', which compromised the individual policymakers with respect to actions that might affect business interests (Durand 2006: 200, Crabtree and Durand 2017: 124, 181) and so become victims of culture capture (Kwak 2013). By way of example, Távera notes that although a law<sup>60</sup> was passed in Peru to ensure that ex-employees wait at least a year before returning to their original employer, the law had '*little effect on the autonomy of regulators and their transparency*' (Távera 2006: 219). Meanwhile, Arce cites tax reform and pensions privatizations to assert that new institutions which threaten business interests can themselves be compromised (Arce 2006: 39-43).

A cultural explanation of such corruption set out by Diego assumes that particular cultural conditions make corruption a common and accepted fact, because 'premodern' political systems needed corruption as a lubricant in order to function. Hence terms such as 'patronage' and 'clientelism' are used to describe the exchanges of favours and the misappropriation of public funds and resources that support caudillos, presidents, dictators, and generals. Public acceptance of some forms of corruption is encapsulated in the phrase *Roba pero hace obra* (He steals but does work) (Diego 2016), referring to bribery which results in works being undertaken that otherwise would not have been. According to a survey

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<sup>60</sup> Law 27332 passed on 27th July 2000

conducted during the 2014 Lima mayoral elections, the same year the code was launched, 41% of Lima residents reported that they could vote for a candidate of their choice, even if it were found that he was a ruler who ‘steals and does work’ (Diego 2016: 79). The corrosive effect of this tolerance to corruption is that it ‘leads to an ethnocentric and relativist concept of truth which causes scepticism towards political discourse’ (Diego 2016: 79), and it erodes confidence in the whole political process and public life in general. Such culturally embedded tolerance of corruption was, as I will discuss later, the main reason why Peru was selected as Odebrecht’s main locus outside of Brazil for its campaign of widespread subversion of public procurement of infrastructure projects.

Prominent authors point to the need for more transparency in public affairs (Durand 2006: 201, Távera 2006: 217) but, given the close and secret relationship between the public and private sectors in Peru, this desire must also surely extend to a need for greater transparency in corporate affairs, hence the need for a code of good conduct for corporations.

### **3.4 The code was launched with mixed motives and ambitious goals**

Peru launched a new voluntary governance code in 2014 following a collaboration between fourteen state, regulatory, financial market, and business institutions,<sup>61</sup> along with several regional NGOs,<sup>62</sup> to replace a limited set of guidance principles introduced in 2002. The new code was introduced with annual reporting obligations on a comply or explain<sup>63</sup>

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<sup>61</sup> SMV: *La Superintendencia del Mercado de Valores*; PROCAPITALES: *La Asociación de Empresas Promotoras del Mercado de Capitales*; Centro de Estudios de Mercados de Capitales y Financiero; MEF: *El Ministerio de Economía y Finanzas*; SBS: *La Superintendencia de Banca, Seguros y Administradoras Privadas de Pensiones*; FONAFE: *El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado*; BVL: *La Bolsa de Valores de Lima*; CAVALI S.A.: *La Institución de Compensación y Liquidación de Valores*; ASBANC: *La Asociación de Bancos del Perú*; El Comité de Fondos Mutuos de ASBANC; CONFIEP: *La Confederación Nacional de Instituciones Empresariales Privadas*; AAFP: *La Asociación de Administradores Privadas de Fondos de Pensiones*; IPAI: *El Instituto Peruano de Auditores Independientes*; MC&F: *Mercados de Capitales, Inversiones y Finanzas Consultores* (OECD 2016 (c) 58).

<sup>62</sup> For example: The The Latin American Round Table on Corporate Governance in 2001; IGCLA: *Institutos de Gobierno Corporativo de Latino América* in 2012 with the support of the IMF, OECD and the GCGF: *Foro Global de Gobierno Corporativo* (Zarate, 2013)

<sup>63</sup> Comply or Explain: firms’ statutory returns must indicate whether the firm complies with each requirement in the code and, if it does not, explain why.

basis for all corporations listed on the Lima stock exchange (BVL). The *Superintendencia del Mercado de Valores* (SMV), the regulator responsible for implementation of the code announced ambitious objectives for it:<sup>64</sup> ‘...to generate a true culture of corporate governance in Peru, which improves the perception of corporations by investors, promote business development and contribute to value creation in the Peruvian economy’ (SMV 2013). In addition to launching the governance code, Peru also established, under the auspices of the SMV, another mandatory requirement – that corporations submit a Sustainability Report alongside their compliance submission. This was passed with legislation in 2015 and launched in 2016. I will expand on this topic in Chapter 7. Regarding the governance code, and likely also the sustainability reporting, here is some evidence to support the claim that Peru was subject to norm cascade<sup>65</sup> in its adoption of the OECD-inspired code. Peru’s adoption of a full governance code in 2014 was broadly coincident with that of six other countries in the region<sup>66</sup> though Peru was the last of the members of the Pacific Alliance<sup>67</sup> to introduce a full voluntary governance code (OECD 2016 (c)). The launch in 2011 of the *Mercado Integrado Latinoamericano* (MILA), the Pacific Alliance’s joint stock exchange, may have provided an additional catalyst to create a comparable process for monitoring corporate governance for firms which would be quoted on the shared exchange. There is also evidence for other motives that would increase Peru’s susceptibility to such a cascade effect. Respondents involved in the process cited awareness at the time that

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<sup>64</sup> Peru is distinctive in having such ambitious objectives for its code; with its Pacific Alliance partners have more prosaic and practical objectives. For example, Chile: ‘to be a tool for investors to have sufficient information to make correct investment decisions’; Colombia: ‘to be a guide of the best corporate practices which is expected to be adopted and put into practice by issuers that intend to raise their standards of corporate governance’; Mexico: ‘to help companies in the process of institutionalisation; transparency of its operations; appropriate disclosure; to be competitive in a global world; to be able access to financing on favorable terms; to have stable succession process; and to be permanent over time for the benefit of its shareholders and third parties’ (OECD 2016 (c): 19, 46-56).

<sup>65</sup> The notion that when a critical mass of states adopts the new norm the rest rapidly follow (Finnemore and Sikkink 1998)

<sup>66</sup> Mexico in 1999, Brazil in 2000, Colombia, Costa Rica and Argentina in 2007, Chile in 2012 (OECD 2016 (c))

<sup>67</sup> An Alliance established on 23<sup>rd</sup> April 2011, comprising Mexico, Chile, Colombia, and Peru

the adoption of the OECD-inspired code could favour Peru's application to become a member of the OECD ([Respondent: 25/19](#)). By 2013, two of Peru's partners in the Pacific Alliance had already become members of the OECD<sup>68</sup> and Peru itself became the first member of the OECD's Partner Country Programme in 2014. Brinks, Levitsky and Murillo point out that institutions inspired by objectives such as OECD membership can lead states towards being satisfied with weak institutional outcomes ([Brinks et.al. 2020: 22](#)).

Yet the launch was seen as more of an experiment than a ploy. I was told that a decision had been explicitly taken to launch a *voluntary* code rather than to attempt to use hard law to enforce standards of governance because there would be the potential for achieving very high standards of governance with some corporations, and because such a strategy would enable the authorities to be more demanding in the future. By contrast, a compulsory code would have '*set the bar too low*' for it to have been widely accepted and would have made subsequent attempts to set higher standards of governance more difficult if not impossible ([Respondent: 25/19](#)).

### **3.5 Institutional weakness challenged a successful implementation**

Peru, like other Latin American countries, has relied on the international diffusion and importation of institutions and legal structures modelled on those in more developed economies (as set out in §1.2), and the 2014 code is a good example of such an importation albeit modified by reference to other codes.<sup>69</sup>

However, commenting on the region's record on institutional importation, Lora concluded that much of the institutional importation and building across the region post the

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<sup>68</sup> Mexico on the 18<sup>th</sup> May 1994, Chile on the 7<sup>th</sup> May 2010, and then Colombia on the 28<sup>th</sup> April 2020).

<sup>69</sup> The Latin American Round Table report that the Peruvian code took counsel from: i) Basel Principles; ii) European Commission's Green Paper: Corporate Governance Framework; iii) Guidelines for a Latin American Corporate Governance Code - CAF; iv) NYSE's Corporate Governance Rules/ contents of Sarbanes-Oxley and Dodd-Frank Act; v) OECD Principles of Corporate Governance; and vi) 'Some European codes'. ([OECD 2016 \(c\): 59](#))

Washington Consensus<sup>70</sup> had been fragmented both in its conception and in its implementation (Lora 2007). Levitsky and Murillo provide a possible explanation for this fragmented track record by emphasizing the role of supporting institutions and of the dangers of building new institutions on weak ‘foundations’ (Levitsky et.al. 2009, 2013: 93).

Institutions that are copied from other jurisdictions will first have been designed in those ‘donor’ jurisdictions in the context of other supporting institutions. If similar institutions are not available in the ‘host’ jurisdiction, implementation will be compromised.

I noted in Chapter 2 that the UK Combined Code had been designed to address the principal-agent problem by separating the board from management. To achieve this goal, the new code was to be supported by several extant institutions: a large and actively-traded stock market and strong regulator, independent directors able to ensure that the board are accountable for their decisions and in turn hold management to account; the presence of institutional investors interested in supporting the independent directors on the board and in influencing the firms in which they invest; the existence of otherwise generally dispersed shareholders (the principals) who could be assumed to be independent of management (the agents); and a system of hard law that will provide back-stop protection for minority interests (Spira and Slinn 2013, Varottil 2020).

In Peru, the listed market lacks strength in every one of these institutions. The principal-agent problem is not an issue because there is very little concern that management will not follow the wishes of controlling shareholders.<sup>71</sup> The Peruvian stock market (BVL) is small by G7 standards with less than a half of the level of market capitalization and less than 10% of the level of trading compared with GDP. Typically listed corporations have little

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<sup>70</sup> Washington Consensus – a term used to describe an ambitious set of proposals for restructuring Latin American economies along staunch market lines (Wise: 2003: 5)

<sup>71</sup> In fact, there is a different problem, the potential exploitation of minority shareholders by controlling shareholders.

float,<sup>72</sup> which means that the BVL has less traction over corporations than the LSE or the NYSE (de la Torre, Guzzi and Schmuckler 2008: 126). The BVL also has some anomalous features first, because of the forced registrations of corporations for reasons of probity rather than their own need for finance<sup>73</sup> and second, because of the forced issuance of investment only shares to workers in 1970 under Velasco's military regime<sup>74</sup>. Furthermore, the main regulator, the *Superintendencia del Mercado de Valores* (SMV) in the years after the code was launched, had a poor reputation as a market regulator. According to *La Voz del Mercado*. Peru was the only one of the Pacific Alliance members where the 'net perceived effectiveness'<sup>75</sup> of its regulator, the SMV, was *negative* at -9% (EY & BVL 2016: 20, 21). EY and BVL concluded that '*there is a need to have a regulator who ensures the proper implementation of regulations while promoting good practices and act with severity in case of infractions*' (EY & BVL 2016: 22). Wise attributed this poor performance to under resourcing of the SMV which was not revamped along with the *Superintendencia de Bancos y Seguros* (SBS) in the early 1990s (Wise 2003: 200). The SMV therefore provided little practical support to corporations by way of setting expectations and a less-than-useful information system for analysing compliance with the code in any detail or reporting publicly on progress (OECD 2016 (c): 58,59).

Independence of outside directors from either shareholders or management is problematic: first, because of a parliamentary board system in which board directors represent particular block controllers, so the need for independence is hardly recognised; second, because there is not a stock of independent professionals to fulfil such roles and in

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<sup>72</sup> Float: the percentage of a corporation's issued capital available for trading

<sup>73</sup> I discussed this topic with officials at the BVL but was unable to obtain a list of the firms' identities (Respondents 6/19 and 19/19).

<sup>74</sup> Under the *acciones laborales* of the military government of Juan Velasco Alvarado (1968 – 1975), corporations were required to extend shareholdings to certain group of workers typically in the form of shares with no voting rights denoted 'investment' shares., I determine that this affects 48 corporations.

<sup>75</sup> Net perceived effectiveness: (% Effective + % Very Efficient) - (% Slightly Effective + % Not Effective)

some instances, controllers turned to family members; and third because outside directors are appointed by the same controlling directors with whom they are required to work on boards and board committees, and so may require special courage to manifest their independence (Varottil 2020). Institutional investors are represented by four pension fund administrators<sup>76</sup> because of a privatization initiative in 1992 (Arce 2006). However, the pension funds are not recognised as active investors by Capia – a prominent local fund manager and market observer - and until quite recently they did not engage directly with the corporations in which they invested. They are also perceived to have conflicts of interest, first due to their desire to invest in international equities for better returns, and second because of their ownership by banks which preferred to encourage the pension funds to invest in cash and bonds rather than shares, since the banking commissions were higher. Peru lacks a widely dispersed shareholder base due to the inequalities in income and wealth. Rather, the actual shareholders are more typically characterized as controlling shareholders representing large blocks of family wealth and frequently with direct involvement in management (Schneider 2013).

Peru, therefore, has several gaps in the institutional architecture upon which the design of the voluntary code was predicated. These gaps are likely to compromise the functioning of the code as an effective institution. The institutional literature offers several further challenges to institutional importation and development, all of which are relevant to Peru.

Regarding the original motivations for an institution, Weyland considers that institutions that do not emerge from the preferences and choices of the actors concerned, are more prone to fail (Weyland 2009: 44). If there is pressure to adopt a ready-made institution, as could be asserted here with corporations, there is a danger that state elites settle for the form but not the substance of a Western-style institution so that their local version of the

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<sup>76</sup> There are in addition in Peru some small mutual funds, but these are not material.



institution becomes a façade. Pérez-Caldentey and Vernengo (2017: 215) point out that lurking under such a façade are the inappropriate behaviours prevalent in the *host's* institutional ecosystem. Therefore, even if implementation of the new institution seems to be effective *'one would find neither that the behaviour of economic agents conforms to the prescribed conceptions of mainstream neoclassical economics nor that selfish behaviour responsive to market incentives would lead to growth...'*

As the case studies in Chapter 6 will reveal, there were several inappropriate behaviours<sup>77</sup> that persisted well beyond the launch of the 2014 code. Brinks, Levitsky and Murillo warn against over-ambitious objectives, instances of which appear to be in play in Peru. When authorities set a very high standard for a new institution for political reasons, they may have little commitment to, or expectation of, compliance in the near term (Brinks et.al. 2020: 22) and this may have implications for how governance information might be interpreted for example by international investors. Similarly, authors refer to the trade-offs that may be made during implementation of any new institution between efficiency and social legitimation (Strang and Macy 2001, Tolbert and Zucker 1983). Though new institutions might be implemented for reasons of efficiency, they may become uncoupled from the original efficiency goal and persist with a merely legitimising role (Levitsky and Murillo 2009, 2013). The prevailing legal system as pertains in Peru also plays a role in such mission creep. Zattoni and Cuomo note that such favouring of legitimacy over efficiency is especially prevalent in countries with legislatures of Napoleonic heritage (Zattoni and Cuomo 2008:13) and such concerns have been found especially relevant to corporate governance codes and to the protection of minority shareholder rights (Aguilera and Cuervo-Cazurra 2004: 424, La Porta, Lopez-de-Silanes, Shleifer and Vishney 1998).

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<sup>77</sup> For example, the continuation of collusion in bidding for road construction contracts through the so-called Construction Club involving COSAPI and Graña y Montero.

These challenges appear daunting, but it is not the case that Peru lacks the capacity to develop new institutions. Since the neo-liberal reforms, the country has developed a good reputation for macroeconomic institutional development<sup>78</sup> (Dargent 2015, Wise 2003) to drive economic growth, the so called ‘Islands of Efficiency’, but not for institutions that might either damage the interests of corporations (Durand 2006: 200, Crabtree and Durand 2017: 124, 181) or protect the rights of consumers and pensioners (Crabtree and Durand 2017: 87).

### 3.6 Conclusions

Peru is in many ways typical of other countries in the region: it has a legacy of family-owned businesses operating within a tradition of hierarchical capitalism, with limited financial markets, a civil law legislature, and limited experience of the principal/agent problem for which voluntary codes were first invented to tackle. It is therefore as good a representative of the issues associated with the importation of a voluntary code to the region as any other country.

However, Peru also stands out with some unique characteristics that make it an especially interesting case study – its societal divisions and inequalities are more clearly framed in racial terms (Drinot 2006: 15 – 19), while its legacy of listed firm corporate governance is considered especially exclusionary (Crabtree and Durand 2017: 53) despite the clear economic success of its productive sectors. Peru also played a central role in an enormous international public procurement scandal<sup>79</sup> that became public in 2017, but Peru’s response was notable because it took direct action against corrupt individuals including four

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<sup>78</sup> As noted, the Ministry of Economy and Finance (MEF), the tax ministry (*Superintendencia Nacional de Aduanas y de Administración Tributaria*), the central reserve bank (*Banco Central de Reserva del Peru*), and the financial sector regulator (SBS)

<sup>79</sup> Lava Jato/Odebrecht. Peru was selected by Odebrecht to be its coordination hub outside Brazil.

ex-Presidents, something that is still lacking in other countries. These distinctions make Peru an especially interesting as well as representative case study.

Corporate governance may not be an issue that has much saliency for most citizens of any country. Drinot notes that even though organisations may *'play the game'* according to the rules established by institutions - to the extent that the rules seem to be set systematically to discriminate against large sectors of the population - it is not surprising that many Peruvians have come to expect little from the organisations that play according to those rules (Drinot 2006: 20). However, the 2014 corporate governance code aims to change the game in Peru, not just the rules, because of its emphasis on constitutive rules and the introduction of new participants into governance along with new deontic rights and obligations. To the extent that reform of corporate governance holds the prospect of introducing more transparency – via the scrutiny of trained independent outsiders - of the quasi-private dealings of a small group of people who control much of the nation's wealth and opportunity - it is worth exploring thoroughly.

## Chapter 4: Methodology

### 4.1 Introduction

Given the choice of Peru as my country case-study, I will here set out a thorough and evidence-based exploration of the impact of the implementation in 2014 of a corporate governance code on the listed corporate sector. I also specify how I will provide clear and rigorous logic for my judgements about the hypotheses regarding corporate decision-making set out in Chapter 2.

First, in §4.2, I will develop the points regarding coexistence, equifinality and contestation mentioned above because they relate directly to the methodology and the interpretation of findings.

I propose to use ‘mixed methods’,<sup>80</sup> that is, to combine analysis of the copious data on corporate compliance - compiled by the regulator from annual returns provided by the 200+ corporations listed on the Lima stock exchange<sup>81</sup> - with qualitative research including interviews, reference to documentary evidence and process tracing in a small-N sample of corporations. The details of the specific quantitative and qualitative methodologies are uncontentious and so to avoid duplication, I leave a detailed description of these to the relevant chapters: in Chapter 5, I will discuss the data available on corporate compliance and my use of methods such as linear regression and csQCA; in Chapter 6, I will discuss case study selection, Bayesian Process tracing and Bayesian Inference as a precursor to presenting corporate case-studies; and in Chapter 7, I will discuss the process I use to explore Peru’s emerging institutional ecosystem. However, the methodological literature expresses concern about the fundamental differences in the epistemological bases of quantitative and qualitative research. I therefore propose to discuss these here in §4.3, and to present my preferred

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<sup>80</sup> The term ‘mixed methods’ is in inverted commas because I will be using a single inference methodology to form judgements from multiple sources.

<sup>81</sup> I compiled a database in excess of 130,000 data items which the SMV collects annually from the 200+ firms registered on the BVL relating to their compliance with the 88 questions in the code from 2014 to 2020.

approach to this apparent dilemma: to use Bayesian Inference to ensure that my conclusions are clear, robust, and defensible.

## **4.2 Reflecting the context of corporate decision-making**

The research question itself is clear, but here I reflect on the nature of corporate decision-making with three further observations on the theoretical framework set out in Chapter 2 because they relate to the interpretation of findings. First, the three mechanisms are likely co-exist on a contingent basis in any corporation; they are not intended as exclusive explanations for a corporation's decision-making about corporate governance, rather their use depends on the circumstances of the corporation. I would expect to see different mechanisms in play and so need to make a judgement about the one most relevant to decisions about the governance code. Second, the causal factors under consideration by corporations will differ according to the circumstances of the firm, and so from an analytic perspective there will be equifinality. I would therefore expect to see different factors involved between corporations that are using the same decision-making mechanism. Third, the parts of the code that will be most contested are likely to be the most promising area to observe differences between corporations and so to focus investigations and these are likely to be the so-called constitutive rules which offer third-parties improved access to corporate governance. I will therefore concentrate some analyses on behaviours around the constitutive rules.

### **4.2.1 The rival mechanisms coexist in corporations**

I propose to consider that all the three rival mechanisms coexist in any given corporation and are activated or come to the fore in particular circumstances. It remains to be seen if this is the case, but there are good reasons to consider it so. Craig Parsons (2007: 15) situates all political science explanations into a single ontological typology. In this framework the rational choice and organisational mechanisms and the cost avoidance

strategies of soft law could be classified as ‘institutional’ and ‘ideational/psychological’ explanations of institutional phenomena and are not alternative world views. Similarly, Scott proposes a three-part definition of the institution itself which describes regulative, normative, and cognitive characteristics as common features of all institutions and so incorporates the apparently contrasting perspectives of the two neo-institutional schools into a single ontological model (Scott 2014 Ch 3 - 4). Both Parsons’ and Scott’s frameworks argue for combining alternative epistemological explanations into a common understanding of the corporation.

A second argument is based on neo-institutionalist practice. A third neo-institutional school, historical neo-institutionalism, evolved from macrolevel comparative analyses of policy formation between states or large firms (Campbell 2004: 23 - 5). This school proposes no new underlying mechanisms to inform the introduction of a new governance code, but its adherents combine aspects of both rational choice and organisational schools. They adopt a pragmatic approach to analysing institutional aspects of organisations using both the logic of instrumentality and that of appropriateness and so implicitly acknowledge that both mechanisms coexist in a single organisation (Campbell 2004: 27, March and Olsen 1989, Hall and Taylor 1996).

This conclusion is important because it means that firms are not defined by a particular decision-making mechanism; rather, they are able to choose how to respond to circumstances, to choose from what are rival approaches and deploy the appropriate or preferred mechanism contingently, and to use different models in different contexts.<sup>82</sup> Not only do all three hypothesised mechanisms coexist and have the potential to be represented in

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<sup>82</sup> For example, corporations may adopt different decision-making approaches to taxation, supply-chain management and industrial espionage.

a single corporation, the process by which each corporation responds to outside factors via these mechanisms is a somewhat unique process.

#### 4.2.2 Equifinality exists in multiple explanations for high code compliance

Corporations have their own individual circumstances, business models, and strategies and so can be expected to have their own pattern of engagement with the world outside the corporation. The mix of factors which they take into account in the deployment of a decision-making process with regard to the code will also be idiosyncratic. This is an important assertion because it will be reflected in any analysis of process-tracing that is conducted to explain compliance as *equifinality*, that is, across corporations, there will be multiple alternative explanations for high compliance with constitutive rules.

Organisational institutionalists typically operate at a level of abstraction above the individual organisation to include a population of organisations or individuals that participate in a common meaning system referred to as ‘the field’ (DiMaggio and Powell 1991: 84, 85). Organisations exposed to a similar field assume similar characteristics as a consequence, a phenomenon dubbed ‘isomorphism’,<sup>83</sup> which allows little room for individuation. This rather narrow view of firm behaviour is reinforced by the institutional logics literature which - in an attempt to create a typology of organisational forms, identifies seven ‘logics’, only two of which apply to commercial organisations, one to professional partnerships and one to corporations<sup>84</sup> (Friedland and Alford 1991: 248 – 253).

However, much of the literature reviewed here would argue for the opposite; that firms are autonomous agents. Soft law theory allows for a differentiated picture of firm behaviour through describing the clear cost burden on corporations created by codes of

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<sup>83</sup> Isomorphism occurs via one of three types of mechanism: mimetic, or copying the practice of other players; normative, or professionalisation throughout the executive ranks; or coercive, as a result of force (DiMaggio and Powell 1991: 67-70).

<sup>84</sup> Other forms of business exist, for example: privately owned; family owned; mutually owned, whether by customers, employees or suppliers.

practice. Corporations react by adopting cost-avoidance strategies but are unlikely to adopt identical strategies to one another since they are each seeking competitive advantage. In the institutional literature, Helmke and Levitsky (2006: 13) took North's four-part model further by developing a typology of the relationships between informal and formal institutions. They concluded that when the formal rules are weak actors are free to develop their informal institutions (in this case, their own governance practice constructed internally) to meet their own objectives. The result is that: *'informal institutions structure incentives that are incompatible with the formal rules'* and which may be in outright competition with them.

This view of organisations as active and autonomous agents is reinforced by North (1990: 5) who views organisations as *'players who attempt to devise strategies and to win'*. Furthermore, Schmidt promotes a granular view of organisations by noting the importance of the negotiation processes within a corporation that comprise a more complex ideational construction of ideas (Schmidt 2010: 9). She draws on authors such as Woll (2008) to adopt a differentiated view of the firm or organisation: rather than subscribing to a vision of the firm as possessing a single corporate rationality, each corporation pursues its own ideas and interests in its own manner. Similarly, Searle asserts an involved process in which institutional facts are created from brute facts by an assignment of function and are held in place by collective intentionality of a host of agents with deontic powers (Searle 1995: 113 – 126). However, he makes no claim of isomorphism.

In the case of corporate governance therefore, these factors may be interpreted in idiosyncratic ways by each corporation and so create the institutional facts as understood within that company given its own group of agents and deontic powers - even though, to some degree, these institutional facts may resemble those existing in other companies. This dispersed quality makes corporate governance distinctive as an institution since each corporation has great latitude in relation to how rules and codes of best practice may be



implemented. This contrasts corporate governance with the many institutions that have been studied elsewhere - whether economic or political - which most frequently have a defined output, whether this is an election result, macroeconomic stability, or a functioning health service, judiciary, or postal service. In the case of corporate governance, there is no special meaning to the *collective* behaviour, there is merely the behaviour of individual corporations pursuing their own business objectives. Finally, each of these literatures emphasises Simon's notion of bounded rationality – on the part of corporations and external agents, further reinforcing the existence of multiple mechanisms leading to a high constitutive compliance outcome. The theory therefore assumes that equifinality exists, and corporate governance may be considered as a dispersed economic institution.

#### **4.2.3 Constitutive rules define the likely area for contestation**

To focus the research, it will be prudent to identify the rules that are most contested since it will be there that the role of the rival mechanisms will most stark. Despite North's definition of institutions as the rules of the game, very little is said about the characteristics of the rules that might comprise an institution.

The philosopher Searle<sup>85</sup> developed a first-principles approach to assert a 'General Theory of Institutions' (Searle 1995:113 - 126). He renames rules that precede the existence of an activity, and so define it, as *constitutive*, and those that follow the activity, so corral what already takes place, as *regulative*. He goes on to identify several new concepts: the relative importance of constitutive over regulative rules which have a crucial role in institutional creation; *institutional facts* which are transformed from *brute facts* by an *assignment of function* through the mechanism of *constitutive rules* and are the cornerstone of institution formation; the transformation of brute facts into institutional facts occurring because of the *collective intentionality* of the *agents* concerned who both *assign new function*

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<sup>85</sup> Searle built on an earlier framework developed by Rawls (1955) in which he defined two concepts of rules.

to brute facts and assign new *deontic rights and obligations* to themselves or other agents.

These *new status functions* of agents either may either enable agents do things they could not do previously or oblige them to do things they would not previously have done. The collective intentionality of agents is key to the maintenance of institutional facts.

The components of this General Theory of Institutions map directly onto the case of the introduction of a new governance code. Here, Searle's 'institutional facts' are the new values, processes and behaviours brought about by the introduction primarily of the *constitutive* rules contained within the new governance code. These rules assign new functions to the old governance processes and introduce new deontic rights and obligations to existing agents in the governance process. More importantly, they also introduce new deontic rights on *newly introduced third parties*. In this way, the constitutive rules therefore go beyond North's declaration to *redefine the game*. These new third parties include: external agents such as INEDS, on the board and staffing board committees; external board appraisers, and auditors; internal agents with new status functions, such as heads of compliance, ethics, and compliance functions; heads of compliance and ethics training; and the wider workforce undertaking training in governance and compliance issues, who are empowered to use the whistle-blower channels. These factors - constitutive rules; new status functions; new deontic rights and obligations of existing and new agents combine to define a new 'game' of corporate governance. The new governance game is sustained by the collective intentionality of new and existing actors with newly assigned deontic rights and obligations who reinforce the new behaviours both directly and indirectly.

Voluntary governance codes tend to include new actors; for example, independent directors and board evaluators, and new processes; for example, new rules for auditor appointments and new obligations to minority shareholders. In this sense, any voluntary

governance code will be seeking to change the game of governance by including these third parties in previously private governance processes.

#### **4.3 Using Bayesian Inference to resolve issues with mixed methods research**

Quantitative and qualitative research techniques represent different epistemological traditions which not only in the theoretical realm but are also embedded in distinct training trajectories of researchers (Goertz and Mahoney 2012, Jick 1979: 602). Some care is needed with their combination. There is ongoing debate about how best to achieve effective mixing of methods which focuses on two issues: operational practice and epistemology.

First, there has been great concern over how best to deploy different methodologies practically and effectively, in particular the combination of population-level statistical analysis and case studies in order to optimize the value to be gained from each technique. The metaphor of triangulation is much used in the hope that the mere use of different techniques might reveal complementary and relevant perspectives (Jick 1979:603, 604) although the visual metaphor does not adequately capture the real differences in these traditions. Moreover, there is an underlying assumption that one technique or the other remains as the arbiter of last resort whether favouring small-N qualitative case studies (Jick 1979: 609) or large-N quantitative methods (King, Keohane and Verba 1994). Some authors have even been engaged in running debates (Beck 2006, Collier, Brady and Seawright 2010). Others have proposed various practical approaches to operational integration as the most effective research strategy, for example: better alignment of qualitative research with causal explanation aimed at exploring processes, mechanisms and linkages between events (Maxwell 2004: 251 - 259); a focus on particular types of causal mechanisms (especially INUS<sup>86</sup> causality), or on causal-process observations (CPO) and data-set observations (DSO)

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<sup>86</sup> INUS: An insufficient but necessary causal factor as part of an unnecessary but sufficient cluster of causal factors, see Mackie (1965)

which would be evident both within-case and across-case studies (Mahoney 2008, 2010); integrating or linking methodologies in practical ways so that there is a flow of insight and information between qualitative and quantitative methodologies (Seawright 2016: 47, Goertz and Mahoney 2012: 12, 20,21).

The second issue concerns a more fundamental difficulty: that there remains an epistemological incompatibility between quantitative and qualitative techniques. This arises because the techniques focus on *different questions* even though they may be addressing the *same topic*; quantitative techniques focus on the determination of population-level parameters<sup>87</sup> while qualitative techniques focus on, amongst other things, in-case-study tracing of causal mechanisms, without any - as Seawright puts it - serious intellectual interaction between the two at any level of detail (2016:45, 46). Whatever the level of operational integration, the inferences drawn from each technique need to be integrated into a single conclusion, and the basic question of whether, and exactly how, qualitative, and quantitative approaches can be combined is not yet settled (Mahoney 2010: 144).

A solution to this epistemological issue is provided by Bayesian Inference,<sup>88</sup> which is designed to ensure that all evidence is drawn into a single causal inference process that is blind to the particular methodology used to generate that evidence. This is achieved by establishing a set of rival hypotheses which are mutually exclusive and exhaustive, and focusing all evidence collection, collected through whatever means, into contributing to a common evaluation of those hypotheses. The fundamental tenets of this approach are: first, that all inference concerns judgement and belief, even the most technical of frequentist statistics; and, second, that such judgements are best made on the relative merits of rival hypotheses, that is, to ask '*which of two actual and competing theories fits the facts better*'

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<sup>87</sup> Such as mean, standard deviation, variance, p-value etc.

<sup>88</sup> Bayesian Inference uses Bayes' Theorem to update support for a hypothesis as more evidence emerges.

(Kuhn 1962: 147) rather than trying to ‘prove’ that a single hypothesis is a good description of reality without context.<sup>89</sup> Bayesian Inference builds on these tenets to offer a rigorous and transparent means of expressing one’s belief about rival hypotheses and how that belief may be altered when new evidence is considered.

There are several benefits of using Bayesian Inference in this study including: 1) that it provides a single causal inference framework that can be used with data sourced from multiple methodologies and so subsumes frequentist analysis; 2) it is suited to testing multiple, and perhaps evolving, MECE hypotheses; 3) it enables the efficient use of data by allowing the evidence used in theory development to be also used in theory testing; 4) it is compatible with practical approaches to integrating different research methodologies for optimal effect; 5) it is inherently transparent and provides an automatic audit trail of the reasoning to facilitate challenge; 6) any concerns over the subjectivity of Bayesian Inference should lead one, in the best tradition of BI, to set these against the rival approach, undertaking the same reasoning without an explicit process.

Bayesian Inference is not intrusive on a traditional research process, rather, it is used to frame the initial hypotheses rigorously - which can only be a benefit - and then as a late-stage interpretative activity and final evaluation stage.

#### **4.3.1 Bayesian Inference in theory**

Bayesian Inference uses a particular application of Bayes’ theorem that deals with conditional probability: a consideration of how one’s belief in a probability might change with the emergence of new information. I will first set out the logic of the use of *Bayes’ theorem as an inference tool* and then discuss two concepts that are intrinsic to the use of explicit Bayesian Inference, both of which warrant detailed explanation. These are the use of

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<sup>89</sup> The challenge to the single hypothesis approach is that it ignores the possible existence of other hypotheses which may have even better explanations and it can encourage bias in the selection of evidence. This is still the case if a single hypothesis is compared with a null hypothesis based on an unrealistic counterfactual.

two or more *rival hypotheses*, and the notion of the *weight of evidence* to express relative belief in rival hypotheses, thus allowing a focus on highlighted evidence and the exclusion of otherwise merely ‘interesting’ or ‘descriptive’ evidence.

### The use of Bayes’ Theorem as an inference tool

Bayes’ Theorem refers to the probability of occurrence of related outcomes, whether events, findings, or results of analyses, and is concerned with conditional probabilities. There are many derivations<sup>90</sup> available due to the theorem’s wide applicability but there is wide acceptance of the following expression<sup>91</sup>:

$$P(B|A) = \frac{P(A|B) \times P(B)}{P(A)} \quad (1)$$

Bayes’ Theorem is relevant to inferential thinking if the first term is framed in response to the question, what can we infer about the validity of a hypothesis H<sup>92</sup> following the discovery of evidence E, and how does that evidence affect our previous level of belief in H? Bayes’ Theorem can be recast with H and E replacing A and B respectively:

$$P(H|E) = \frac{P(E|H) \times P(H)}{P(E)} \quad (2)$$

Or more clearly:

$$P(H|E) = P(H) \times \frac{P(E|H)}{P(E)} \quad (3)$$

This expression indicates that the belief, as measured by a probability, accorded to a hypothesis being true upon obtaining evidence E (known as the *posterior* probability) is equal to the *prior* belief in the hypothesis being true [P(H)] before the evidence was available, multiplied by an *updating* factor P(E|H)/P(E). This factor is the ratio of two terms related to

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<sup>90</sup> There are many derivations of Bayes Theorem which becomes self-evident from alternative ways of expressing joint probabilities: University of Chicago Department of Astro Physics: <https://astro.uchicago.edu/~kent/fnal/bayes.pdf>; university of Pennsylvania Department of Education: <http://www.hep.upenn.edu/~johnda/Papers/Bayes.pdf>; The Corporate Finance Institute: <https://corporatefinanceinstitute.com/resources/data-science/bayes-theorem/> and Pearl (2009: 5)

<sup>91</sup> This reads as follows: The probability of B given the certainty of A equals the probability of A given the certainty of B, multiplied by the probability of B, all divided by the probability of A.

<sup>92</sup> In this case the hypotheses are about causal mechanism for corporate decision-making

the emergence of the evidence: the conditional probability of E **emerging** given that the hypothesis is true [P(E|H)], and the probability of the evidence emerging at all. [P(E)].

The challenge with this updating factor is that although some judgement may be made about the probability of the evidence E emerging given that the hypothesis H was true based on an examination of the ‘world’ implied by the truth claim, the denominator P(E) cannot realistically be evaluated; the evidence has either been found or not<sup>93</sup>. Equation (3) is not yet useful in this form. However, the utility of equation 3) is greatly enhanced if a pair of rival hypotheses is considered because then all the terms are subject to reasonable estimation.

### **The importance of considering rival hypotheses**

The use of rival hypotheses is crucial in Bayesian Inference because it permits a focus only on quantities that can reasonably be estimated in practice. With two rival hypotheses H<sub>1</sub> and H<sub>2</sub>, the inferential task is made easier, that is, to discriminate between the two hypotheses rather than make an absolute judgement about one or the other. Bayes’ Theorem for evidence E and for the first hypothesis H<sub>1</sub> would be:

$$P(H_1|E) = \frac{P(H_1) \times P(E|H_1)}{P(E)} \quad (4)$$

and for hypothesis H<sub>2</sub>: 
$$P(H_2|E) = \frac{P(H_2) \times P(E|H_2)}{P(E)} \quad (5)$$

Dividing expression (4) by expression (5) cancels<sup>94</sup> the P(E) terms so that we are no longer dealing with absolute probabilities but rather with *relative values or ratios*:

$$\frac{P(H_1|E)}{P(H_2|E)} = \frac{P(H_1)}{P(H_2)} \times \frac{P(E|H_1)}{P(E|H_2)} \quad (6)$$

*Posterior = Prior x Likelihood*  
*Odds       Odds       Ratio*

<sup>93</sup> In some cases proportionality is all that is required and P(E) is treated as a normalizing term.

<sup>94</sup> (4):  $\frac{P(H_1|E)}{P(H_2|E)} = \frac{P(H_1)}{P(H_2)} \times \frac{P(E|H_1)}{P(E|H_2)} \times \frac{P(E)}{P(E)}$  On division of (4) and (5) the terms in red can be deleted

Expression (6)<sup>95</sup> reads that the Odds Ratio of  $H_1$  and  $H_2$  given the (same) evidence in each case, may be determined from the Prior Odds Ratio of the two hypotheses multiplied by the Likelihood Ratio of the evidence bundle emerging under each of the hypotheses in turn.

Alternatively, *posterior odds = prior odds updated by the likelihood ratio*.

Expression (6) is tractable in a way that (3) is not because all of the terms on the right-hand side can be estimated. The Prior Likelihood Ratio can be estimated based on known information from completed studies or set to one [1] reflecting no prior preference for either hypothesis. Meanwhile, the Likelihood Ratio can be estimated by considering the evidence in the context of the ‘world’ of each hypothesis in turn and then making an explicit judgement as to whether the evidence is more or less likely in the contrasting and alternative worlds implied by a truth claim for each hypothesis.

### **The use of Weight of Evidence as a metaphor**

In practice, a further step is required to render expression (6) not only tractable but also useful for processing multiple bundles of evidence; that is, to transform the number scale representing likelihood ratios into one using integers representing log odds and to the intuitive notion of the weight of evidence. Simple ratios have two problems: first, progressively higher ratios begin to appear congested on the number scale when close to 0 or 1<sup>96</sup> and evade intuitive understanding (see [Fairfield and Charman: 2022: 131](#)); and second, ratios must be multiplied on combination, compounding the congestion. These difficulties can be avoided by transforming the 0 - 1 number scale onto a logarithmic scale representing instead of likelihood ratios the logarithms of likelihood ratios or log odds.

Given the identity in expression (6) above, if I take the logarithm of each side of the expression, the result is also an identity as I show in expression (7).

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<sup>95</sup> Note that the three new terms in expression (6) are no longer probabilities but odds.

<sup>96</sup> Since the expression of likelihood ratios involves fractions or numbers on a 0 – 1 scale, high likelihood ratios involve tiny gradations of numbers near to zero or to 1 which are difficult to interpret intuitively. A ratio of 1:4 may be expressed as 0.2:0.8, but a ratio of 1:40 would be expressed as 0.0244:0.9756.



$$\log \left[ \frac{P(H_1|E)}{P(H_2|E)} \right] = \log \left[ \frac{P(H_1)}{P(H_2)} \right] + \log \left[ \frac{P(E|H_1)}{P(E|H_2)} \right] \quad (7)$$

*Posterior* = *Prior* + “*Weight of Evidence*”  
*Log Odds*    *Log Odds*.                    *Evidence*”

The left-hand side of expression (7) is known as the *posterior log odds* of H<sub>1</sub> relative to H<sub>2</sub>.

The first term on the right-hand side is known as the *prior log odds* of H<sub>1</sub> relative to H<sub>2</sub>.

Following Good (1985) the final term, which is the logarithm of the likelihood ratio, is called the *Weight of Evidence* in favour of hypothesis H<sub>1</sub> relative to H<sub>2</sub><sup>97</sup> (Fairfield and Charman 2022: 127). Alternatively, *posterior log odds* = *prior log odds plus weight of evidence*.

Use of a logarithmic scale to represent likelihood ratios offers distinct advantages. First, a logarithmic scale mimics how our physical senses operate for example, for sound intensity as measured in decibels,<sup>98</sup> a sound that is doubling in loudness is expressed as increasing by the addition of 10dB, and a quadrupling by the addition of 20dB, which is intuitively appealing. This is especially so with the notion of the Weight of Evidence – as successive evidence is considered the effect is to add or subtract<sup>99</sup> from the extant weights of evidence. Second vanishingly small numbers representing high likelihood ratios are transformed into integer values for log odds which can be combined by addition rather than multiplication<sup>100</sup>. Third, this transformation into a logarithmic scale in which multiplication is replaced by addition has great practical value. In the typical project, evidence emerges or is considered at different times. The Weight of Evidence metaphor enables successive updating of early hypotheses as evidence either emerges or is processed. Each posterior conclusion becomes the prior to be updated through consideration of the next bundle of evidence, and so

<sup>97</sup> Weight of Evidence is also termed log (Bayes Factor).

<sup>98</sup> Decibels are used to express the logarithmic ratio of two magnitudes of any unit, see <https://www.britannica.com/science/decibel>.

<sup>99</sup> For two evidence bundles and two hypotheses, if E<sub>1</sub> is more likely under H<sub>1</sub> and has a positive WoE, if E<sub>2</sub> is then more likely under H<sub>2</sub>, it will have a negative WoE with respect to H<sub>1</sub> and so be subtracted from the total

<sup>100</sup> Compare the *multiplication* of 0.01 x 0.0001 = 0.000001 with the *addition* of their logarithms base 10 which are integers: -2 + -4 = -6, where the answers are equivalent, i.e., 0.000001 = 10<sup>-6</sup>.

on. This procedure also provides an audit trail of the thinking process which can be amended as insight builds throughout the project. Crucially, the only evidence that is significant, and which is worth highlighting, is that which has the value of discriminating between the hypotheses under consideration. Highlighted evidence is the only evidence that has any ‘Weight’ – all other evidence has no weight and so can be discarded, however interesting it might be.

Fairfield and Charman have developed a protocol for managing this process in practice – they recommend the use of the decibel scale shown in Table 4.1 for calibrating weights of evidence.

**Table 4.1: Calibration for Weights of Evidence for H<sub>1</sub> Relative to H<sub>2</sub>**

Descriptions of difference		Calibration of difference	
‘Plain language’ expression of difference	Acoustic perception as metaphor for difference	Decibels (dB) or “Weight of Evidence”	Equivalent odds ratio
Very Weak	Smallest meaningful difference perceived	3	~2:1
Weak	Noticeable difference	6	~4:1
Moderate/Clear	Twice as ‘loud’	10	10:1
Strong	Four times as ‘loud’	20	100:1
Very Strong	Eight times as ‘loud’	30	1000:1
Extremely Strong	Sixteen times as ‘loud’	40	10,000:1

Source: Author adapted from Fairfield and Charman 2022: 133

The table shows the decibel score to be allocated as the Weight of Evidence in favour of H<sub>2</sub>, in forming a judgement about the likelihood ratio of evidence E occurring either under H<sub>1</sub> or under H<sub>2</sub>. So, if I consider that the evidence is clearly more likely to emerge under H<sub>1</sub> than H<sub>2</sub>, I will assign a 10dB log odds ratio as the weight of evidence. If it were just discernibly more likely, I would assign 3dB and if it were very strongly more likely, 30dB. If the judgements were to favour H<sub>2</sub>, the allocations of decibels would be reversed in sign.

### 4.3.2 Bayesian Inference in practice

My use of Bayesian Inference (BI) will mostly be concerned with evaluating the weight of the evidence collected in the project under rival hypotheses. However, in practice, the theory needs to be adapted to handle more than two rival hypotheses and also different types of research data.

The theory above refers to the relative likelihood of highlighted evidence emerging under a pair of rival hypotheses, but because I have identified three rival hypotheses, I need to adapt the process. To evaluate three hypotheses, the analysis can proceed by making comparisons between just two of the three possible pairings of the three hypotheses, using the one that is common to both pairs as a calibration marker. Throughout this report, I propose to use the Power hypothesis as the calibration marker. This is not an arbitrary decision because my selection of the Power Hypothesis has strong intuitive appeal given my earlier discussion of the impunity of elite dominated corporate boards under hierarchical capitalism: that is, it might be what one would expect to be the case. I begin with a prior judgement about the rival hypotheses and favour the Power Hypothesis over the rivals because of the background information that I have regarding hierarchical capitalism and the controlling and self-protective nature of family block shareholders. I have then used Bayesian Inference for evaluating the evidence bundles emerging from the three modules of research described in §4.1, namely, the combined analysis of compliance records; the case studies; and the research on the evolving ecosystem. In each case, I take the documentary and available testimonial evidence as common bundles. The analysis of each chapter concludes with an evaluation of the believability of the three hypotheses expressed as weights of evidence in decibels for that chapter. These analyses are drawn together into a final posterior judgement in the first section of Chapter 8.

Because of the different natures of the three research modules, I have adapted the methods for creating evidence bundles and for forming an overall judgement on the weights of evidence for each hypothesis. In the first and third modules, I have taken the evidence as a single bundle and highlighted the items of evidence that appear to be most relevant to distinguishing between the hypotheses. An alternative approach would be, in the case of the analysis of compliance evidence, to treat the evidence highlighted in the three analytic modules as separate bundles, to consider the separate likelihood ratios for each, and finally to combine the overall weight of evidence. I explored this approach as a sensitivity and found that it made little material difference to the overall conclusion. In the case of the evidence from the evolving ecosystem research, I could have treated testimonial and documentary evidence separately and combined the separate weights of evidence, while considering the fact that there would be a relationship between these bodies of evidence.<sup>101</sup> Therefore if they had been treated separately, the second bundle would add less to the weight of evidence than the first because of the conditionality relationship. For example, having first evaluated documentary evidence one might reasonably expect certain testimonial evidence to emerge; therefore, such evidence is less surprising, and its likelihood must be conditioned on that of the documentary evidence, i.e., it must be reduced.

In the case study research, I have used a different treatment. Each corporation is a stand-alone entity, so I first evaluated the weight of evidence for each case study taking the documentary and testimonial evidence together as in the other two modules. These conclusions represent my judgement about how each corporation responds to the code. However, there is an issue around how to combine evidence from multiple case studies to

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<sup>101</sup> Documentary and testimonial evidence from or about a similar source are related either because of authorship or interviewees having read material. The BI treatment for such relationships is to down weight the ‘first’ evidence under consideration because it will be less extensive but consider the ‘second’ evidence as conditionally related i.e.  $P_2 = (E_2|HE_1B)$  and not  $P_2 = (E_2|HB)$ , where B is the common background information.

establish an overall judgement about the hypotheses based on the evidence arising from the case study module. I set out to address the following question: how do the case studies and highlighted evidence inform my judgement about the role of the hypotheses in corporate decision-making? To do this, I re-evaluated all the evidence *including* the conclusions from the firm level BI and so considered the *additional highlighted evidence of the impact of hypothesis use on outcomes*, something possible from a macro-level analysis but missing from the micro-level. (I had considered three arithmetical approaches to combining the results from the case studies,<sup>102</sup> but rejected them all because they would have missed the additional evidence relating the use of one of the decision-making approaches to outcomes).

I then summed the individual weights of evidence from the three research modules to arrive at a consolidated view of the posterior judgement of the weight of evidence for each hypothesis, then provided an interpretation of the combined results.

### **4.3.3 Mitigation of risks of using Bayesian Inference**

The risks associated with using Bayesian Inference are both minor and manageable. First, there may be concern over subjectivity in assigning prior probabilities.<sup>103</sup> The literature identifies three alternative ways of doing this: use informative priors based on previous studies or theoretical predictions; establish empirical priors based on observed data; or use uninformative priors if there is no prior knowledge (Zyphur et al 2015: 395 - 398). The default position is to adopt even probabilities across all hypotheses thereby taking away any bias and leaving judgements to be determined by the evidence.

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<sup>102</sup> The three discarded arithmetical approaches: 1) sum weights of evidence from successive case studies – this would soon result in excessively large weights and risk over-favouring case study evidence; 2) treat successive case studies as conditional on previous evidence. This would become arithmetically complex and would pose the risk of not reflecting potentially important differences between case studies; 3) take an arithmetic mean – this would be dependent on case study selection and the cases were not chosen to be representative.

<sup>103</sup> In subjective approaches, as here, there is only a need to establish a probability reflecting prior judgement about the degree of belief in the hypotheses, and not a probability distribution as would be the case in scientific applications.

The second risk is that the definition of *Evidence Bundles* and the assignment to these of *Weights of Evidence* is also subjective and so may bias the results because different researchers might choose different weights and so come to different conclusions. Here the remedy lies in the transparency of the process which facilitates discussion between alternative approaches. The definition of evidence bundles is a practical matter, I aim for the simplest approach and subject it to sensitivity testing. The judgement of a weight of evidence is a measure of how much more or less likely evidence is considered to be under the pair of hypotheses in question and it is slightly more complex. In practice a numerical and semantic scale is used to support judgements and to make them explicit as set out above in Table 5.1 from Fairfield and Charman ([ibid 2022: 133](#)). Alternative approaches to quantification exist, for example, an alternative is provided by Andraszewicz et. al. ([2015](#)) adapted from Jeffreys ([1961](#)) which provides 11 levels of judgement from 100 times *more* likely that evidence would appear under  $H_1$  to 100 times *less* likely so favouring  $H_2$ . This scale uses a logarithmic scale (base 3),<sup>104</sup> so moving a judgement from one ‘level’ to the next implies a likelihood ratio altered by a factor of three and is supported by clear interpretations of the strength of belief implied at each level.

Whichever logarithmic scale is used (along with its clearly defined interpretations), I consider the assigning of weights of evidence to be a robust process and one that will be entirely transparent. In any case, it will be possible to carry out sensitivity analyses and other checking procedures post hoc. These might include scrutinizing influential bundles of evidence; exploring logical linkages between evidence bundles; considering evidence in different order; or reframing bundles. The definition of the evidence bundles themselves

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<sup>104</sup> Logarithmic scales are used to mathematically transform the multiplication of estimates of probability into the more intuitive addition of logarithms and to make more intuitively clear the differences in high likelihood ratios. Other authors prefer to use log base 10 and to use the metaphor of decibels ([Fairfield et al 2022: Ch 4](#)). This is an example of Weber-Fechner Law: intuitive human sensations tend to be logarithmic functions of the stimulus ([Jaynes 2003:91-93](#))

requires judgement and adherence to guidelines as provided by Fairfield et.al. (2022: 109-117, 137-142). However, it should be noted that the process of sifting evidence and deciding what is relevant, and how it should be framed and made distinct from other evidence, and how the credibility of sources is judged, are all activities that are carried out without Bayesian Inference anyway but likely with less transparency and discipline.

Third, there is an operational risk that the maths somehow ‘takes over’. In the design of this project all the necessary research needed to reach a conclusion without a Bayesian approach will be carried out and different methods integrated operationally for optimal effect just as they would be in a project without Bayesian Inference. Bayesian inference will then be used to crystallize judgements about the meaning of items of evidence - such judgements would need to be made in any case, but likely less explicitly without the support of Bayesian inference. In any case, a default to a heuristic approach still maintains the disciplines of Bayesian Inference set out above.

#### **4.4 Ethics and risk management**

This research is inherently ‘low risk’ however, I have considered potential concerns about the balance of power, ethics and risks associated either with respondents or the interviewer. All the interviewees were senior professionals in their own fields: either shareholder, directors, non-executive directors or senior employees of major corporations, or directors or senior managers of regulatory agencies professional services firms or regulators. Everyone was interviewed within the context of their professional duties, only their professional opinions were sought, and all the interviews were carried out remotely over Zoom because of COVID-19 restrictions on travel. The balance of power, ethics and risk management issues are therefore considered to be minor. A full evaluation of each is contained in Appendix 4 along with a detailed description of the mitigations employed.

## Chapter 5 Analysis of factors influencing corporations' compliance.

### 5.1 Introduction

In this chapter I explore the data on code compliance which is supplied annually by listed corporations in Peru to the regulator, the *Superintendencia del Mercado de Valores* to identify the factors associated with high level of corporate compliance with the 2014 code. My findings confirm several aspects of the theory developed in Chapter 2: first, that constitutive rules are indeed more strongly contested than regulative rules if resistance to adoption can be taken as an indicator of contestation. Compliance with the regulative rules is typically double the level of compliance with constitutive rules which are the rules that change the game of governance by introducing both participation of and increased obligation to third parties. Second, six factors are strongly associated with higher code compliance, especially for constitutive rules, and account for almost one half of the variance in compliance between corporations. These factors are the identity of the regulator; the industry sector; participation in Peruvian equity markets; participation in international equity and bond markets; and the structure and location of the business group to which the corporation belongs. Third, there is clear equifinality – there are several different combinations of the six factors that lead to high code compliance, indicating that corporations are both rooted in their individual set of circumstances and exposures to external agents but that they are also making their own decisions about how to respond to the code. Moreover, there is also a cumulative effect: the more factors to which a firm is exposed the higher their level of compliance. Fourth, there is clear evidence that the conditions of sufficiency causality through INUS combinations of factors and compliance are met though, considering the extensive equifinality, the conditions for necessary causality are not met.

I will use the findings from my analysis here to update a judgement about the relative plausibility of the rival hypotheses using Bayesian Inference – as outlined in Chapter 4 - in



combination with similar updating exercises from Chapters 6 and 7. And all drawn together in Chapter 8.

In the next section, I will describe the data in detail including the dependent variable and the several independent variables along with their associated mechanisms. Then in the subsequent sections I will go on to present the results of the analyses.

## **5.2 Data and variables**

### **5.2.1 Compliance data**

Corporations report annually on their compliance with the voluntary governance code introduced in 2014 through submissions<sup>105</sup> by firms to their regulator the *Superintendencia del Mercado de Valores*<sup>106</sup> (SMV). These are publicly available on their own websites (see bibliography for URLs) as well as being available in aggregate from the SMV. The corporations' annual returns to the regulator are in two parts: first, a simple 'Yes'/'No' answer in response to each of the 88 questions<sup>107</sup> in the code, to indicate whether the corporation complies; and second, in the case of a 'No', a brief narrative to offer some explanation to the regulator for the firm's non-compliance. I have obtained this data through a blend of direct downloads and provision of data bases from staff at the regulator (SMV) and have converted the 'Yes'/'No' answers to '1'/'0'. In total there are approximately 210 annual returns with 88 responses for each of seven years or comprising a potential database of over 100,000 entries, though in reality, only 157 firms reported consistently in all seven years.

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<sup>105</sup> Memoria which accompanies the corporations' annual financial statements and reports

<sup>106</sup> The SMV has overall responsibility for collecting annual firm compliance returns. The *Superintendencia de Bancos y Seguros* (SBS) has the responsibility for regulating the financial sector and perform a similar role to the PRA and FSA in the UK.

<sup>107</sup> The 88 questions are ordered into five groups reflecting different aspects of corporate governance: shareholder rights; conduct of the AGM; board composition and conduct; risk management; and transparency.

### 5.2.2 The dependent variable(s)

Throughout, compliance is taken to be either the number or the proportion of the questions to which the firm offers a ‘Yes’ response and this represents the dependent variable. I have used one or other of two treatments depending on the circumstances. In some cases where simple parameters are being evaluated, I use the compliance *score* - that is, the number of ‘Yes’ responses - as the dependent variable. I have used this measure for the overall population of corporations and rules, and for sub-groups which I will define later. In some cases where I considered that normalization might be required, for example in the use of multiple linear regression where the dependent variable should be a continuous numerical variable, I operationalised the dependent variable as a compliance *index* (CI), representing firms’ percentage compliance with a range 0% to 100%.<sup>108</sup> Since the total number of questions at 88 was not materially different from 100, I judged that the score or the CI could be interchangeable without causing confusion. These two treatments, directly using the base compliance scores or a simple percentage are superior to the alternatives. I considered using a weighted index, for example giving equal weight to each of the five categories of question typical in governance codes (Footnote 84). However, I rejected this approach because the categories of questions are not immutable features of firm behaviour and there is a great deal of overlap between them, so equal weighting would serve little purpose and could be misleading.

I tested the validity of the compliance score in three ways. First, regarding its mathematical construction: the index for 2017 was evaluated using Cronbach’s Alpha<sup>109</sup> and scored 92.5% or ‘*Excellent*’ on the Alpha scale indicating its high internal reliability as a

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<sup>108</sup> Some firms (4 in 2017) will be excluded because of ongoing liquidation or direct involvement in the stock market, and some questions (6) will be excluded from the analysis because they are contingent on the status of the firm.

<sup>109</sup> Cronbach’s Alpha is a measure of the internal consistency and reliability of a scale. An Alpha above 90% indicates ‘highly reliable’).

measure of code compliance (Nunnally 1978, Lance, Butts and Michels 2006: 205,6)<sup>110</sup>.

Second, I tested its robustness for comparability. Although over 200 firms completed returns each year, the number varied from year to year by a few percent of the population and not all firms' returns were available from the SMV for all seven years. The score or the index could be used to make some comparisons of compliance between years for example to compare variance, but when identifying trends, I used the returns of 157 firms that completed returns for all seven years. Third, I tested for integrity of completion. In interviews with expert observers in 2019, some concerns about the integrity of the data were raised, namely that firms might be submitting dishonest returns i.e., that the submitted information did not correspond with the reality of governance pertaining in firms. However, there is no consistent check available for this possibility short of firm-by-firm investigation, and so this topic will instead be explored in interviews.

Since an important aspect of the theory developed in Chapter 2 is to understand the role of constitutive rules which represent only a part of the full complement, I have used two other dependent variables to represent distinct compliance indices for constitutive and regulative rule groups. As above, these appear both in simple numerical and percentage terms, as appropriate to the analysis being conducted.

### **5.2.3 The independent variables**

Part of the quantitative research is predicated on identifying associations between corporate compliance and independent variables<sup>111</sup> (IVs), which reflect aspects of a corporation's situation and relationships with third parties, whether these are expressed as economic incentives or sanctions, or other forms of power relationship perhaps embodied in a

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<sup>110</sup> In contrast, the five sub-groups were rated more poorly: Board – 'Good', AGM and Risk – 'Good/Acceptable', Minority Rights and Transparency – 'Not Acceptable'.

<sup>111</sup> Independent variables will be referred to as such but also as factors, exogenous incentives, or conditions, commensurate with the type of analysis being carried out.

field of influence. I developed a potential list of such factors from the review of theory and supplemented it during the research process based on interviews with corporation executives and expert observers.

I then operationalised twelve of these factors as potential IVs: regulatory obligation; industry sector; shareholding structure; active local equity trading; local bond issuance; international equity listing; international bond issuance; group affiliations; supply chain relationships; SMV sanctions; multiple BVL listings; and affiliations to major families. Each of these potential IVs could be associated with a distinct causal mechanism that could influence a corporation's compliance. I deal with these later in the chapter and focus here on the methods used for constructing an auxiliary data base of factors as they pertain to listed corporations. In the main, I used information collected for 2017, to represent the mid-point of the period under study and, because the real-life circumstances represented by these factors were stable year on year, I assumed that 2017 could be taken to represent the period 2014 to 2020. Each of the dozen IVs explored required a tailored approach to its construction which I discuss under four broad headings to avoid repetition. Regulatory obligations and sanctions data were collected directly in list form from the SMV, the overall compliance regulator, and the SBS covering financial firms. I consulted the SMV website detailing sanctions during the period 2014 to 2020 by date and corporation. I accessed industry sector and supply chain relationships data initially from the SMV website.

However, in use I found the industry codes to be problematic and recreated a sector list by inspecting every listed firm's website and taking a view of the most appropriate industry code to apply. Some supply chain relationships were especially important because of the special nature of the suppliers' global brand and its need to maintain its reputation in the local market. I reviewed all eight corporations via their websites and company accounts as well as through in-depth interviews for a small-N sample. I compiled data on shareholding

structures from the SMV, consulting company websites and annual reports to identify ownership affiliations both to determine the nature and structure of group affiliations and to identify the presence - either through ownership or involvement in management - of family business groups. I collected data on corporations' financial markets activities from a range of sources. For local equity trading data, I used two BVL sources of data, the first being membership of the general index comprising the largest traded and market capitalized corporations, and the second being analysis of disaggregated trading and market capitalization data. I used information on multiple stock market listings and bond issues provided by the SMV website supplemented by information from company annual accounts.

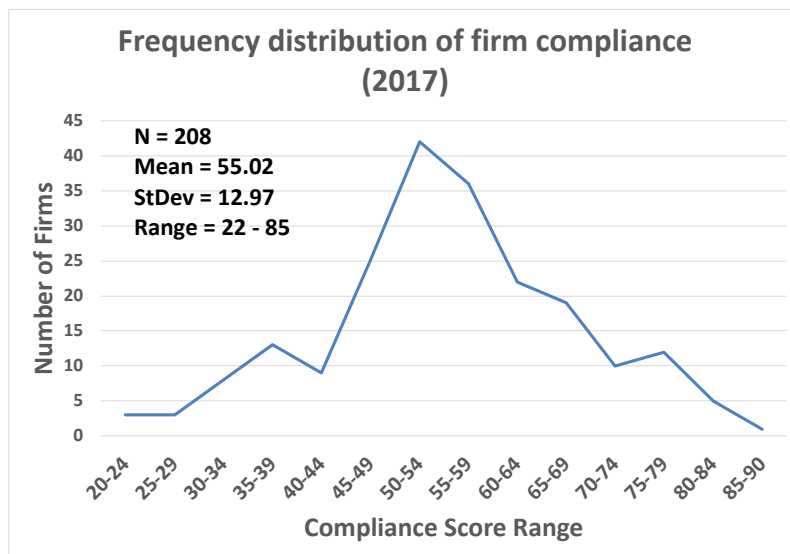
In each case the IVs were first examined to identify the nature of any associations with corporate compliance. I then explored further the IVs with material associations and described the possible mechanism by which any association with corporations' compliance might be realistic. I also represented the IVs by factorised dummy variables for the purposes of multiple linear regression in §5.4 or as dichotomous variables for use in csQCA in §5.5, a process which I will describe in the relevant sections.

### **5.3 Identifying factors associated with high levels of compliance**

#### **5.3.1 Contestation over constitutive rules**

In this section I show that corporations differ greatly in the degree to which they comply with the 2014 code and that an important area of contestation concerns constitutive rules which introduce third parties into corporate governance. Firstly, I show in Figure 5.1 that there is a great deal of difference in corporations' compliance with the code.

**Figure 5.1: Wide variation in corporate code compliance (2017)**



Source: Analysis of SMV returns for 2017

This wide range of compliance indices for corporations is the key phenomenon I seek to explain in this thesis. The data from 2017 are representative of other years in the period 2014 to 2017. Average firm compliance with the code did show some modest growth during the period 2014 to 2020: for a consistent group of 157 corporations reporting for all seven years, the mean compliance score increased at an average rate of approximately 0.4 compliance points per annum from 55.1 in 2014 to 57.4 in 2020 perhaps suggesting the influence of exogenous factors on corporations. However, there was very little overall change in the variance in the distribution of firms in the same period. One might expect that as the overall compliance index increased, there would be some narrowing of the differences between low- and high-complying firms, for example by low-compliance firms ‘catching up’. However, the standard deviation of the distribution increased between 2014 and 2017 and then decreased to its original level. Some of the change in compliance behaviour in the early years therefore was due to the higher compliers increasing the differential between them and

the lower-level compliers.<sup>112</sup> In addition, not all firms maintained or increased their compliance year on year; there were a great number of firms changing compliance in any given year. Typically, only 40 – 60 did *not* change their compliance score in any given year; some changed by considerable amounts, and the bulk of increases were compensated by reductions leaving a small average increase ultimately resulting in the overall modest increase during the period.

To explain the variance in code compliance, I will examine the effects of a range of factors. But first, I will explore firms' differential responses to two types of rules contained in the code. Searle's general theory of institutions (2005) indicated that institutional facts were created by constitutive rules which define a new 'game' in contrast to regulative rules that merely change an existing *modus operandi*. Applying this distinction to the rules in the 2014 code, I identify the constitutive rules within the 2014 code based on two criteria. Either that a constitutive rule should introduce a new third party into the governance process, for example by bringing independent directors onto the board<sup>113</sup> or by having them preside over board committees,<sup>114</sup> or, it should introduce a material change in the deontic rights and obligations to existing participants regarding third-party involvement in governance, for example, by having regulations around governance of the AGM, which are binding and non-compliance entails responsibility?<sup>115</sup> (See Appendix 3 for the full list and process used). In the coming analysis I use the compliance scores for constitutive and regulative rules as dependent variables and they both score highly for internal reliability.<sup>116</sup> I appreciate that this becomes a

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<sup>112</sup> See Braumoeller (2006) for a discussion of how causal influences can be expressed through an increase in population variance as well as, or instead of, through an increase in the population mean. That is, in the first half of the 2014 – 2020 period, the high complying firms continued, on average, to improve their level of compliance.

<sup>113</sup> Rule III.7: Is at least one third of the Board of Directors made up of Independent Directors?

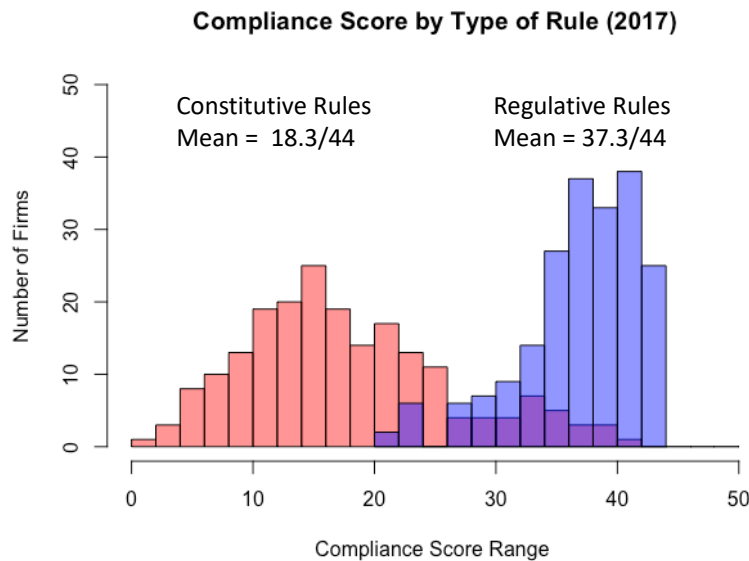
<sup>114</sup> Rule III.12c: Are the special committees chaired by Independent Directors?

<sup>115</sup> Rule: II.2: Does the company have a regulation of the AGM, which is binding and non-compliance entails responsibility?

<sup>116</sup> Cronbach's Alpha both 'Good': constitutive compliance score – 89.3%, regulative compliance score – 84.9%.

somewhat subjective judgement at the margin regarding what constitutes a ‘game changer’ but I show in Figure 5.2 that the difference in the corporate response to these two rule types is effect is very striking and also robust to sensitivity analysis in the form of shifting the emphasis in the distinctions I have made.

**Figure 5.2: Marked difference in compliance with constitutive and regulative rules.**



Source: Author’s own categorization and analysis of SMV returns for 2017

The graph shows two superimposed frequency distributions showing the number of firms complying with constitutive rules (in red/pink) and with regulative rules (in blue) in 2017. The distinction between the distributions is very clear - corporations comply on average less than half as much with constitutive rules as they do with regulative rules, and the difference in the populations is statistically very significant.<sup>117</sup>

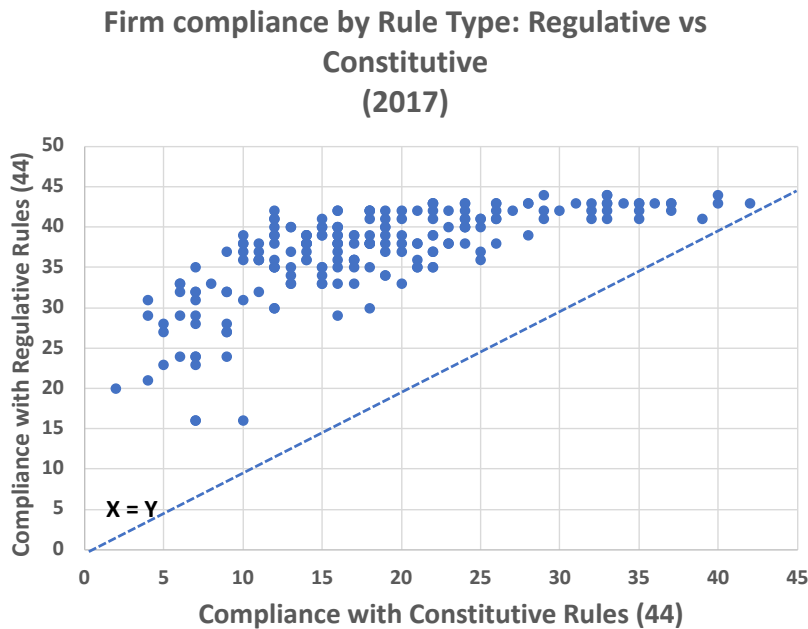
These results confirm the component of theory that identifies corporate leadership as being much less willing or able to admit third parties into their governance processes and/or treat minority shareholders on an equal basis with controlling shareholders. Reluctance to comply with constitutive rules overall is very evident at the firm level, because every

<sup>117</sup> The two groups have a t-test p-value of 1.5E-87.



corporation complies less with constitutive rules than it does with regulative rules, as I show in Figure 5.3.

**Figure 5.3: Constitutive compliance always lags regulative compliance.**



Source: Author’s rule categorization and analysis of SMV returns for 2017

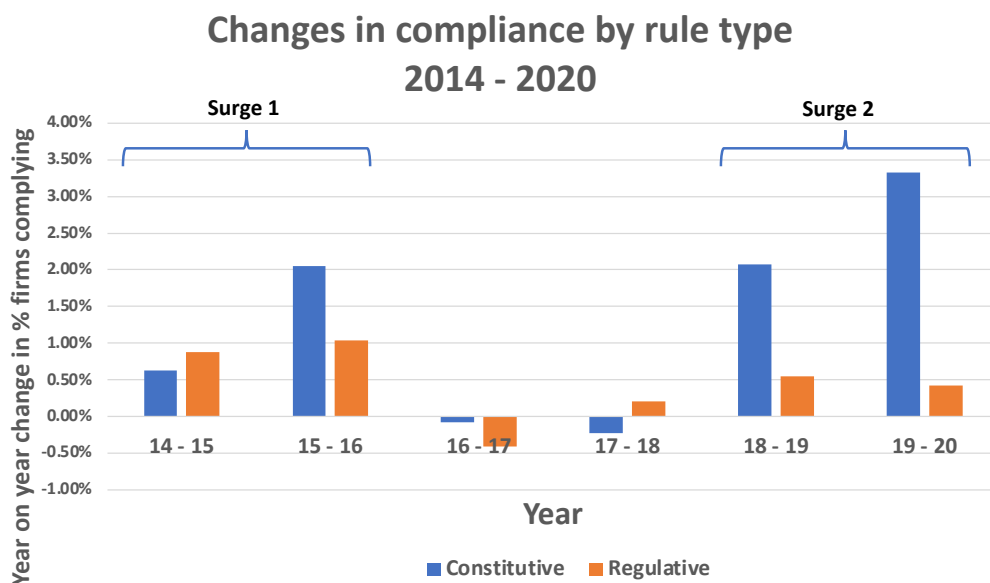
Each dot on the graph represents a corporation’s regulative and constitutive compliance plotted on the y and x axes respectively. In every case,<sup>118</sup> each corporation is more reluctant to accept the constitutive than the regulative rules. For the bulk of corporations, compliance with the 44 regulative rules is on average 18 points<sup>119</sup> higher than it is for the 44 constitutive rules. The difference in rule compliance between very low and averagely compliant corporations is reflected equally in regulative and constitutive rules, but the difference between averagely and high compliant corporations is dominated by the difference in corporations’ constitutive rule compliance.

<sup>118</sup> Because all the dots are above the  $y = x$  line.

<sup>119</sup> The average vertical ‘distance’ between a dot and the  $y = x$  line.

Despite the relative reluctance to comply with the constitutive rules, corporate compliance with constitutive rules grew three times faster between 2014 and 2020 – by 7.6% from 38.7% to 46.3% - than compliance with regulative rules which grew by 2.7% from 82.7% to 85.4% in the same period. Most of the growth in compliance with constitutive rules occurred in the second of two ‘surges’ in compliance in the latter half of the period 2014 to 2020 as I indicate in Figure 5.4.

**Figure 5.4: Constitutive rule compliance outgrows regulative rule compliance.**



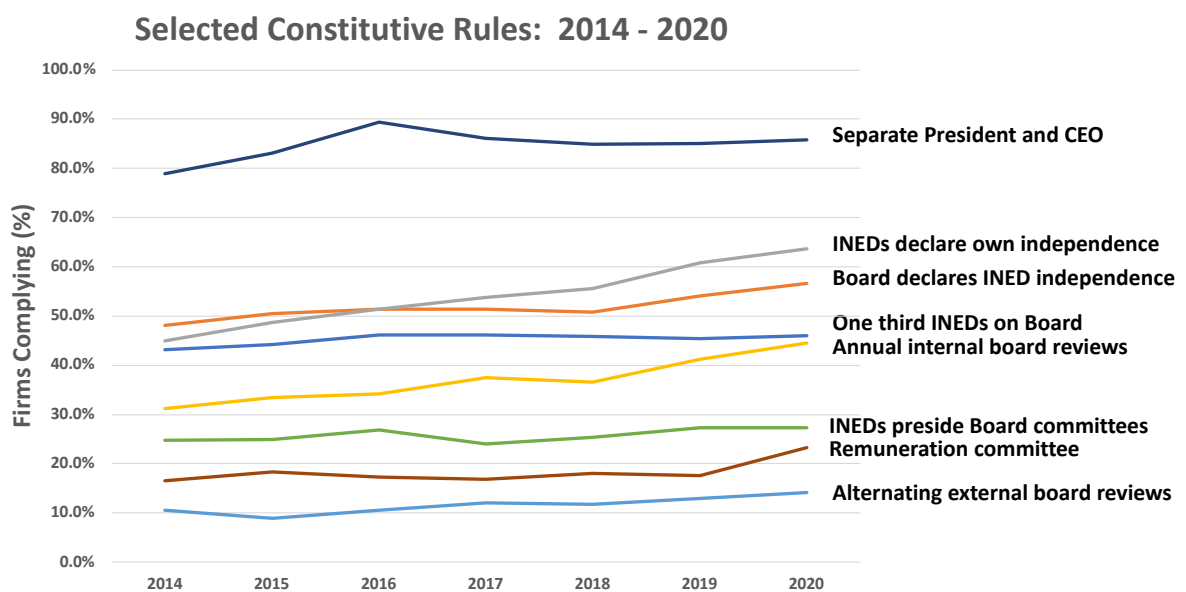
Source: Analysis of SMV returns for 2014 to 2020

The graph shows a comparison of year-by-year growth rates in compliance by type of rule. Although compliance with constitutive rules outgrew that with regulative rules in Surge 1 between 2015 and 2016, the effect was much more marked in Surge 2, which included both periods 2018 to 2019 and 2019 to 2020. These two surges involve different constitutive rules and, as I will show in later chapters, likely involve different causal mechanisms. Surge 1 involved the adoption of a quorum of three INEDs and their *self-declaration* as independent, the presiding of board committees by INEDs, and the separation of the role of President and CEO. The timing of these adoptions is likely a learning effect. In the first year or two of the code case-study corporations reported that they were willing to work on ensuring that

processes were in place before adopting new rules and so there were delays in rule compliance while these processes were implemented, which materialized in 2015 and 2016 (Respondent 1). Surge 2 involved growth in *board* declarations of INED independence, the significant adoption of board appraisals (especially involving *external* evaluators), and the adoption of remuneration committees to set director remuneration, as well as further growth in the presiding of board committees by INEDs. These rules represent important incursions into traditional governance by introducing third parties into governance. They may well be a response to outside influences; from 2018 to 2020, corporations reported that they were responding to extreme exogenous factors— a toughening of the supervisory regime at the SMV, growth in the Sustainability movement and the after-effects of Odebrecht and related scandals (see Chapter 6).

It remains the case that some important constitutive rules that contribute to shaping the game of governance are widely complied with and others much less so as I illustrate in Figure 5.5.

**Figure 5.5: Several important constitutive rules are still contested.**



Source: Analysis of SMV returns for 2014 to 2020

The figure shows eight examples of constitutive rules, three with compliance above 50%, and five with less than 50%, some showing an upward trend, some not. The highest compliance rule shown is the separation of the roles of President and CEO. This has a legacy of family control but appears to have been accepted by most corporations though has reduced a little after the initial growth in surge 1 to 2016. A more contested rule is the requirement for the Board to declare the independence of its INEDs. Despite the new definition of the INED role issued by the SMV in 2019, there is a surprising reluctance by firms to declare the independence of their INEDs, and even by the individuals themselves. Regarding the rules that are more contested with fewer than 50% of firms complying: compliance with the requirement for a quota of one third INEDs on the board has changed little over the period, while annual internal board reviews have grown steadily especially in Surge 2; but INEDs presiding over board committees is still an important control and power issue and the setting up of a remuneration committee also represents a handing over of power to non-controlling shareholders. Finally, alternating internal board reviews with external reviewers who are likely seen as tougher is also strongly resisted.

I conclude that constitutive rules represent the main area of contestation for corporate owners and leaders, and there are some important initiatives to introduce outsiders into corporate governance that are being resisted. However, I will show that constitutive rules are the category that is most likely to be influenced by outside factors. I will now explore the associations between the independent variables identified above and compliance with the code, focusing particularly on corporate compliance with constitutive rules.

### **5.3.3 Analysis of factors associated with high constitutive compliance.**

Of a dozen possible factors studied, I found that six of the independent variables have strong associations with the overall compliance index (highlighted in bold below) and in the

main, even stronger associations with a compliance index constructed for constitutive rules only, as I set out in Table 5.1.

**Table 5.1: Independent variables are strongly associated with corporate compliance.**

Independent Variables		N (204)	All Rules (88)			Constitutive Rules (44)		
			2 Mean CI /%	3 Delta	4 p-value	5 Mean CI /%	6 Delta	7 p-value
<b>IV1 Regulator</b>	SBS and SMV	66	69.2	<b>8.8</b>	<b>1.6E-06</b>	49.2	<b>11.2</b>	<b>1.3E-05</b>
	SMV only	138	60.4			38		
<b>IV2 Industry Sector*</b>	Financial Services and Industrials	107	67.8	<b>9.6</b>	<b>4.2E-07</b>	47.7	<b>12.9</b>	<b>5.2E-07</b>
	Mining, Ag. Utilities, Property, Inf structure	97	58.2			34.9		
<b>IV3a Controlling Shareholders</b>	Single Block S/H	113	64.1	2.0	0.16	42.6	2.12	0.22
	Mult. Block S/Hs	91	62.1			40.4		
<b>IV3b Retail Voters</b>	Retail "Voters"	65	65.7	3.6	0.05	45.2	<b>5.23</b>	<b>0.043</b>
	Retail "Investors" or none	139	62.1			39.9		
<b>IV4a Domestic Equity Mkt Exp</b>	In the BVL General Index	28	74.4	<b>12.9</b>	<b>7.3E-05</b>	56.9	<b>17.7</b>	<b>3.9E-04</b>
	Not in BVL GI	176	61.5			39.2		
<b>IV4b Domestic Bonds</b>	Bonds in issue	34	66.7	<b>4.2</b>	<b>0.028</b>	44.2	3.1	0.16
	No Bonds	170	62.5			41.1		
<b>IV5 Int'l Financial Markets</b>	Int. Equity & Bonds	23	74.2	<b>12.4</b>	<b>3.2E-04</b>	57.9	<b>18.4</b>	<b>1.6E-04</b>
	Domestic Only (BLV)	181	61.8			39.5		
<b>IV6 Business Model</b>	Private Groups (Int./Reg./Local)	142	66.1	<b>9.5</b>	<b>4.8E-06</b>	44.7	<b>10.1</b>	<b>1.2E-04</b>
	Small Peruvian and Public Sector	62	56.6			34.6		
<b>IV7 Multiple BVL listings</b>	Multiple firms	95	64.7	2.7	0.085	43.1	2.8	0.15
	Solus listing	109	62			40.3		
<b>IV8 Family Group</b>	Major Family 'Grupo'	42	64.2	1.2	0.31	42.6	1.3	0.35
	Not Major Family	162	63			41.3		

Source: Author's analysis of data from SMV, BVL 2017 and company websites

\*Note: Industry categorisations have been redefined by author, they are not as offered by SMV

The table shows results for corporate compliance categorized by a selection of independent variables. For each independent variable, I show its incidence in the population

and how the presence or absence<sup>120</sup> of the IV affects compliance. I do this for all rules combined and for constitutive rules. I then highlight the strongest associations – those with high delta and low p-values in bold text and to highlight the stronger associations of IVs with constitutive rule compliance – by comparing columns 3 and 4 for all rules, and columns 6 and 7 for constitutive rules only.

For the overall compliance index, the IVs with statistically significant associations with compliance are IV1 Regulator, IV2 Sector, IV3b Retail voters, IV4a Domestic equity market exposure, IV4b Domestic bonds, IV5 International financial market exposure, and IV6 Business model. In all but one case, the association is even more pronounced in relation to constitutive rules; that is, the IVs except for domestic bonds are associated with a greater discrimination regarding compliance with the constitutive rules. In contrast, IV3a Controlling shareholders, IV7 Multiple listings on the BVL, and IV8 Family Group have weak overall associations. I will discuss each independent variable in turn.

**Regulator.** All listed firms are regulated by the SMV, but only financial services firms are in addition regulated by the SBS. These differences are associated with differences in compliance. The table shows the average compliance for these two groups – and shows a strong association with compliance overall - especially so for constitutive rules. The financial services firms regulated by the SBS show a mean compliance of 69.2% in contrast with the non-financials with a lower mean of 60.4%. The distinction in the populations is statistically significant with a p-value of 1.6E-06. The mechanism by which the SBS might influence financial sector firms is through the issuance of standards and fines with the ultimate sanction of licence-withdrawal leading to business interruption and perhaps fines at best. This is a *statistically significant and strong association*.

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<sup>120</sup> Three IVs have multiple sub-categories: Industry Sector and Business Model which I highlight in the discussion and regression analysis in the next section.

**Industry sector.** Corporations' compliance may be affected by the nature of their supply chain, whether suppliers, partners or customers, and industry sector was explored as a proxy. I reworked the seven industry classifications provided by the SMV - 63 companies were classified as 'diverse' but on inspection these firms did have a sector focus, and several firms either lacked any classification at all or were incorrectly classified – into a new framework which classified all corporations. The table shows average compliance by this reworked set of ten industry sectors which appear to form two groups: Financials and Industrials and the rest (Real Estate, Public Services, Agro-Industrials, Infrastructure, Mining and Private Sector Services) with statistically significant distinctions between the groups. Clearly there is a strong overlap with the regulatory IV, since all financial services firms are regulated by the SBS and so much of this distinction is already explained. As to Industrials, a possible explanatory mechanism for the relatively high compliance of these firms is that a firm's markets will determine its relationship with other agents in the supply chain each of which may espouse values relevant to corporate governance and be able to exert influence over the corporation. For example, sector determines the corporation's exposure and sensitivity to public reputation: customers may be interested in 'ethical' products or local activists may be concerned about environmental protection or Indigenous rights, for which higher compliance might offer revenue and cost-benefits or else avoid distracting legal proceedings. The especially high level of compliance by the investment funds is explained by these firms' roles as institutional investors typically promoting responsible investment and governance in their chosen firms, and so they are role models for good governance. This is a *statistically significant and strong association*.

**Shareholding structure.** Shareholder structure could play a role in affecting corporate governance since many of the rules are directed towards the relationship between the corporation and its minority shareholders and would be a topic of debate for controllers,



The rules also pertain to the notion of independence of INEDs from controlling shareholders – corporations may have a single or multiple large block shareholders and, in addition, may have retail shareholders either with or without voting rights.<sup>121</sup> The table shows the average level of compliance for the type of the control shareholding – whether there is a solus controller or a small number of large shareholders - and, although there is a small difference in mean compliance between these groups, the difference is not statistically significant. On the next row I explore associations of the different retail shareholders in three groups: 92 firms have none; 48 have retail shareholders with no voting rights denoted *investors*; and 65 have retail investors with voting rights denoted *voters*. The presence of voters is associated with higher levels of compliance at a statistically significant level. This may be because much of the code is directed to minority rights and voters who come to the AGM may be vociferous. However, when the block and retail shareholding structures are combined, the coincidence of multiple block holders *and* retail voters is associated with high compliance. The mechanism of influence is for multiple block shareholders through direct representation on the board and for retail voters through the annual general meeting (AGM). This is a *barely statistically significant and relatively weak effect*.

**Domestic market equity exposure.** Corporations raise funds on financial markets with associated conditions and costs. I explored two measures of a corporation’s exposure to the domestic equity markets with essentially the same result: analysis of the 37 high market capitalization and high trading volumes, and membership of the Peruvian General Index which includes of the most highly traded firms (PGI). I present the PGI in the table as

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<sup>121</sup> In 1970 under law 18350, the military government of Juan Velasco Alvarado established *Acciones de Inversión* in which workers in the industrial, mining, telecommunications and fishing sectors in were granted investment-only shares. i.e., with no voting rights. This affected 48 corporations in 2017. Also known as *Acciones Comunes y de Capital*, *Acciones Laborales*, and *Acciones de Trabajo*.  
[https://www2.congreso.gob.pe/Sicr/Congresistas/2006/20060438.nsf/vf02web/DED6C789E18118090525777C0072083F/\\$FILE/Comunicadofinal.pdf](https://www2.congreso.gob.pe/Sicr/Congresistas/2006/20060438.nsf/vf02web/DED6C789E18118090525777C0072083F/$FILE/Comunicadofinal.pdf)

showing *the strongest association*. The table shows that there is a significant difference in the level of compliance with the code for the more actively traded corporations<sup>122</sup>. The mechanism for influence over corporation's governance lies in being recognised as a major equity on the BVL, which exposes the corporation to both scrutiny and to additional incentives established by the BVL for having good governance. This is a *statistically significant and relatively strong effect*.

**Domestic market bond issuance (2020).** The BVL provides a facility for corporations to issue bonds and so provides another touchpoint for corporations whose equity is not actively traded. The table shows that there is a significant difference in the level of compliance with the code between corporations that issue local bonds and those that do not. The mechanism for influence over corporation's governance is that bond issues expose the corporation to the expectations of the AFPs and perhaps also international investors who will either participate in the issue or have pricing expectations for it determined in part by governance. This is a *statistically insignificant and a relatively weak effect*.

**International financial market exposure.** Increasingly, Peruvian corporates are listing on international exchanges or issuing corporate bonds on international markets. Such markets have high standards for governance and expose corporations to larger institutional investors. The table shows that there is a significant difference in the level of compliance with the code between corporations that obtain international finance and those that do not. The effect is especially pronounced with international equity, though the number of corporations doing this is small. The mechanisms for influence over a corporation's governance is like that of the domestic instruments but likely enhanced because of the larger

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<sup>122</sup> I took account of the forced registration of corporations mentioned in §3.4 but conclude that the material difference in compliance occurs when corporations become very actively traded.

exchanges with tougher rules and the exposure to larger institutional investors which may be sought. This is a *statistically significant and relatively very strong effect*.

**Business Model.** There are three aspects of a firm's business model to explore which could have a bearing on its compliance: whether a firm is part of a large regional or international group; whether a firm is a solus listing on the BVL or has other firms from the same group also listed; and whether a firm is owned by one of the leading families. The BVL listed sector comprises a range of business structures - from public companies to solus corporations, to those that are parts of groups -, so corporations are directly exposed to different governance regimes to which they may or may not be required to adhere. The table shows compliance levels by business model. The data show that corporations which are part of either regional, international, or large Peruvian groups have significantly higher levels of compliance than do those that are in Peruvian ownership as small groups or solus firms, or in public ownership. The mechanism of influence could be reduced transaction costs from administrative efficiencies by having common standards throughout a group, having a cadre of executives or INEDs who share a common vision for governance, or, for larger regional and international groups, exposure to international markets with expectations that governance standards will be both high and pervasive throughout the business group. This is a *statistically significant and relatively strong effect*.

**Multiple BVL Listings.** Of the 208 firms listed, 95 are 'multi' listings that is, there are two or more firms from the same group on the BVL. The table shows compliance by firm status i.e. whether it is listed in isolation on the BVL, irrespective of whether it is part of an international group, versus whether it has other firms also listed which are part of the same group. The mechanism for influencing governance is that co-subsidiary corporations may collaborate on matters of governance, and/or achieve higher levels of compliance than they

otherwise would have done. There is a discernible association, but it has *no statistical significance and is a weak association*.

**Family ownership.** There are 42 corporations that are parts of family owned or controlled business groups.<sup>123</sup> A hypothesized mechanism here is that family-dominated groups may have stronger path dependency and attachment to their own informal governance procedures and be more likely to exclude outsiders. In fact, it appears that there is a small negative association with compliance; that is, members of family groups do comply a little less than other firms, but this association is *not statistically significant*.

In addition, case-study interviews revealed three other factors<sup>124</sup> which were thought to have an influence on firms' stance on the governance code, but these have not been explored quantitatively here but I discuss them in the case studies.

Each of the above factors has a clearly articulated mechanism for how influence could be brought to bear by the corporation's engagement with external agents. Each one could be associated with some form of economic incentive whether a direct monetary benefit, a reduction in operating or transaction costs, loss of brand or business reputation, or, at the extreme where the mechanism may be more coercive, loss of the firm's licence to operate or be part of the 'field' of influence where the mechanism may be more coercive. These potential relationships, mechanisms and roles will be explored further in the discussion of the case studies.

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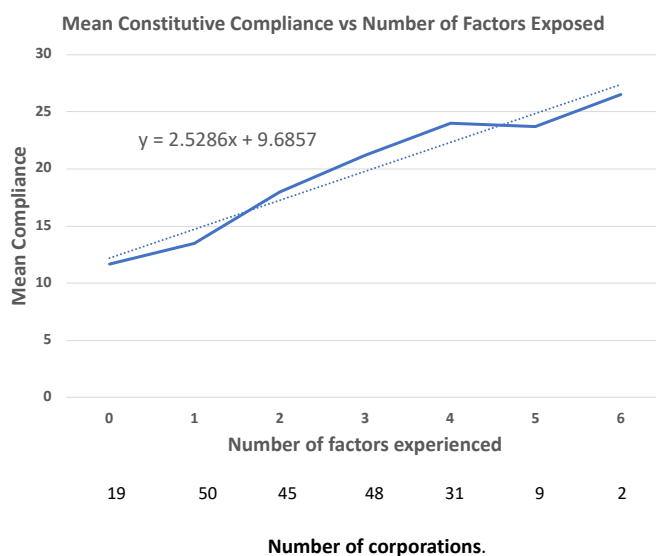
<sup>123</sup> Grupo Intercorp – Rodriguez Pastor family; Grupo Gloria – Rodriguez; Grupo Credicorp –Quevado, Romero; Intursa – Brescia, Brescia-Cafferata; Volcan – Letts Comerares; Grupo Buenaventura – Benavides; Grupo Hochschild – Hochschild; B+Grupo Grana y Montero – Belmont Grana

<sup>124</sup> The additional potential independent variables are: Existence of strong global suppliers (eg Coca-Cola) that wish to protect their brand reputation in Peru; the disclosure of a public scandal (eg the Construction Club or the Odebrecht scandal); and receipt of SMV sanctions which increased in severity during 2014 to 2020. These factors are discussed in more detail in Chapters 6 and 7.

### 5.3.4 The cumulative effect of multiple factors

All the factors to some degree discriminate between corporations based on their compliance with the code. Each of these factors and the associated mechanisms will be explored in the qualitative research. However, it is also important to note that these factors are not experienced by firms in isolation but rather in a multiplicity of combinations. For example, Ferreycorp, an importer of large machinery, is a corporation associated with four factors: it is a significant issuer of local equity; it raises funds on the international bond and equity markets, has a regional group structure and it has retail investors. Meanwhile, Compañía Minera Poderosa is associated with one factor – retail voters. With just six factors showing a material association with compliance, and with just two conditions for each, there are 64 possible combinations.<sup>125</sup> I show in Figure 5.6 in a simplified initial analysis of the effect of combinations of factors that there is a significant association between the number of factors to which a corporation is exposed and its level of compliance with the code – here shown for constitutive compliance.

**Figure 5.6: Factors have a cumulative effect on constitutive compliance**



Source: Analysis of SMV returns for 2017

<sup>125</sup> Seven dichotomized independent variables, provide 2 to the power 6 [ie. 2<sup>6</sup>] or 64 distinct combinations.

The graph shows corporations on the x-axis grouped according to the number of factors they experience along with the number of corporations in each group, and the average constitutive compliance in each group on the y-axis. As the number of factors to which a firm is exposed increases from group to group, the mean compliance also increases, by approximately 2.5 compliance points per additional factor according to the fitted equation. This relationship continues up to six factors in combination.<sup>126</sup> The explanatory mechanism for this relationship could be that each factor in turn has some influence and one can imagine the hypothetical case of a corporation being exposed to additional factors and gradually improving its governance in each case as additional new agents press on new areas of governance of concern to them. I conclude from these findings that there is equifinality, that is, that there are multiple combinations of factors that can be associated with high levels of compliance in corporations. From a policy perspective, this suggests that there is no ‘silver bullet’ to achieving a highly compliant listed corporate sector.

However, the relationship between an agent and the possible incentives and sanctions that might be deployed to influence a corporation’s governance is complex and should not be equated with simple correlative relationships encountered in the natural world. In the case of correlative relationships, adding an input produces an output, more input yields more output and crucially reducing input reduces output. I show a preliminary exploration of the nature of the association between individual factors and compliance in Table 5.2. - there are not clear monotonic associations that would suggest either strong correlations nor the conditions for clear statements of necessity or sufficiency.

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<sup>126</sup> A similar relationship exists between the number of factors and group mean compliance for regulative rules but only up to three factors at which point additional factors have no further influence.

**Table 5.2: No strong correlative relationships exist between factors and outcomes.**

Y Axis: Outcome (Constitutive rules)	X axes: Individual Factors			
	IV1regulator	IV2sector	IV3shareholder	
Compliance: <average >average	0 1	0 1	0 1	-
	0 92 26 1 46 40	0 71 47 1 26 60	0 48 70 1 23 63	
Compliance: < average >average	IV4alocequity	IV4blocbonds	IV5ime	IV6busmodel
	0 1	0 1	0 1	0 1
	0 108 10 1 68 18	0 101 17 1 69 17	0 113 5 1 68 18	0 79 39 1 47 39

Source: Author’s modelling based on SMV data 2017 and information from corporate websites.

The table shows a series of two-by-two matrices allocating 204 corporations to one of four quadrants. In each case the horizontal ‘x’ axis represents a factor from the discussion above but dichotomised to separate the variables into two groups in order to emphasize the greatest disparity between high and low compliance. The vertical ‘y’ axis is also dichotomized with ‘0’ representing lower than average compliance for constitutive rules and ‘1’ representing higher than average compliance for constitutive rules. If the relationships were correlative, the numbers in each matrix would be heavily clustered in the (0,0) or (1,1) cells. As it is, in every case, there are corporations either without the factor but with the outcome or vice versa, shown in red, which would be ‘0’ if there were a strong correlation. This implies that a pure associative relationship does not exist. Nevertheless, the relationships in Table 5.1 and in Figure 5.4 do indicate some level of association – the numbers in black generally exceed those in red - and so it is worth exploring the effect of independent variables in combination.

In the next section I explore further the aggregate effect of multiple factors on compliance, and I begin to quantify how much of the variance in the compliance behaviour of corporations might be accounted for using multiple linear regression.

## **5.4 Quantifying the explanatory power of factors.**

### **5.4.1 Methods**

In this section, I use multiple linear regression to explore factors explaining corporate compliance with the code.

To operationalize this modelling, I represented the independent variables as factorized dummy variables for example as ‘0’ or ‘1’ to represent the regulator variable, or ‘0’ ....’10’ to represent the sector variable. The dependent variable was taken to be firm compliance measured as the compliance index (CI) defined in Chapter 2. In terms of the independent variables, taking into account the relatively low association with compliance of some of the IVs demonstrated earlier, I have restricted the regression to four independent variables: sector; local equity exposure; international bond and equity exposure; and business model. In addition, I use different versions of the dependent variable for comparison purposes: as an index (CI) of overall compliance (DV1), as a CI of compliance with constitutive rules (DV2), and as a CI of compliance with regulative rules (DV3). Finally, I removed six firms from the analysis reducing N to 202: four firms<sup>127</sup> because they were listed as in liquidation in their returns to the SMV; and two further firms<sup>128</sup> because they represent the stock exchange and its settlement function so do not reflect the unencumbered compliance behaviour of corporations.

### **5.4.2 Explaining the variance in firm compliance**

I show in Table 5.3 the effect of the four selected independent variables on corporate compliance with constitutive and regulative rules as separate dependent variables, as described above.

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<sup>127</sup> Fábrica de Hilados y Tejidos San Miguel SA, Hipotecaria Sura Empresa Administradora SA, Rayon Industrial SA, and Sociedad Industrial de Artículos de Metal SAC.

<sup>128</sup> BVL operates the Lima stock exchange and CAVALI is the clearing and settlement house for securities, *Institución de Compensación y Liquidación de Valores* (ICLV).



**Table 5.3: Four factors explain one third of the variance in compliance**

Selected Independent Variables		N	Models			
			Model 1 (DV1)		Model 2 (DV2)	
			Constitutive Rules (44)		Regulative Rules (44)	
			Coefficient	(Std Err)	Coefficient	(Std Err)
<b>IV2 Sector</b>						
1	Public Services	24				
2	Agro. Industrial	14	<b>11.7 *</b>	(5.6)	5.2 (3.7)	
3	Mining	16	-3.6	(5.2)	-0.86 (3.5)	
4	Infrastructure	9	1.9	(6.2)	1.5 (4.1)	
5	Real Estate	14	2.3	(5.6)	2.2 (3.7)	
6	Private Services	20	7.0	(4.9)	3.7 (3.2)	
7	Industrials	39	<b>16.7***</b>	(4.4)	<b>7.8 **</b> (2.9)	
8	Insurance	19	<b>16.8***</b>	(5.0)	<b>8.6*</b> (3.3)	
9	Banking	44	<b>13.9***</b>	(4.0)	<b>7.5**</b> (2.7)	
10	Asset Management*	5	<b>43.0***</b>	(7.6)	<b>15.6**</b> (5.1)	
<b>IV4a Local Equity Exposure</b>						
1	Not in Peru GI	176	-		-	
2	In Peru General Index	28	<b>16.2***</b>	(3.4)	<b>8.0***</b> (2.2)	
<b>IV5 International Market Exposure</b>						
1	None	181	-		-	
2	Bond issues only	18	<b>16.6***</b>	(3.9)	<b>6.1*</b> (2.6)	
3	Bonds + Equity Listing	5	<b>36.9***</b>	(7.3)	<b>10.6*</b> (4.8)	
<b>IV6 Business Model</b>						
1	Public Ownership	44	-			
2	Small Peruvian Group	20	<b>9.6*</b>	(4.8)	2.4 (3.2)	
3	Large Peruvian Group	64	3.3	(3.2)	<b>4.2*</b> (2.1)	
4	LatAm Regional Group	30	<b>7.8*</b>	(3.8)	<b>8.9***</b> (2.5)	
5	International Group	46	<b>8.3*</b>	(3.5)	<b>9.1***</b> (2.3)	
Intercept		-	<b>21.4***</b>	(4.3)	<b>72.7***</b> (2.9)	
<b>Evaluation Parameters</b>		-	-		-	
P-value		-	1.852e-15		1.1e-08	
Adjusted R squared		-	37.8%		24.5%	
Observations		202	202		202	

NB: ( ) indicates coefficient standard error.

Significance codes: p-value: <0.001 ‘\*\*\*’, 0.01 - 0.001 ‘\*\*’, 0.05 - 0.01 ‘\*’

Source: Author’s MLR analysis of 2017 SMV data in R

The table shows the coefficients for two models exploring the associations between the four most significant independent variables and two different dependent variables DV1 measures compliance with constitutive rules and DV2 measures compliance with regulative rules. Each cell contains the coefficients for the four independent variables, a coded measure of its statistical significance coded as shown at the foot of the table and the standard error. The lower rows headed evaluation parameters provide the aggregate p-values and Adjusted R Squared (adj. R<sup>2</sup>) which is a measure of the proportion of the variance in the data which is accounted for by the model.

The first observation is that the statistical significance of both models is very high as shown by the p-values of 1.852e-15 and 1.1e-08. Second, the explanatory power of the variance in compliance is also high for both models, in particular, the adjR<sup>2</sup> for Model 1 at 37.8% indicates that well over one third of the variance in the underlying data is explained by the four selected independent variables. Third, the adjR<sup>2</sup> for Model 1 - with constitutive compliance as the dependent variable, at 37.8% - is larger than that for Model 2 - with constitutive compliance as the dependent variable, at 24.5%. This might imply that the fit of the model for constitutive rules may be somewhat better than it is for regulative rules. Prima facie<sup>129</sup> this would fit with my earlier conclusions about the nature of constitutive rules; that because they are more resisted by corporations since they admit third parties into corporate governance, one would expect the differential effect of exogenous influencers to be more noticeable than for regulative rules. Closer inspection of the coefficients for Models 1 and 2 shows that most of the key coefficients for Model 1 are also larger and have higher statistical significance than those in Model 2, with one exception.

Taking each independent variable in turn: the IV2 Sector coefficients for Industrials, Insurance, Banking and Asset Management are all large, statistically significant, and larger

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<sup>129</sup> This could be an artefact of the 'bunching' in the regulative compliance scores.

under M1 than M2 although the same pattern is evident. A similar pattern emerges for IV4a Local Equity exposure and for IV5 International Market Exposure with larger coefficients and in the case of IV5 greater significance. It is interesting to note that the association of equity markets, both domestic and international, is stronger than of the bond markets. The pattern for IV6 Business Model is more complex. Interestingly, the model results are reversed: the coefficients under M2 are greater than those under M1 indicating that the exogenous factors and conditions have a greater effect on regulative rules than constitutive rules. This effect could be explained by the adoption of a more routinized approach to regulative rules across international groups, although the differences in the coefficients are not very large.

### **Factors influence firm compliance through understandable mechanisms**

Close inspection of the coefficients suggests a possible clear interpretation of these findings and possible mechanisms. The higher coefficients evident in M1 for the independent variables representing industry sector (incorporating the regulatory distinctions), and local and international financial market exposures, can be hypothesised to reflect the interests of the outside groups concerned, and the importance placed by third parties on the role that constitutive rules play in good governance. In the case of the regulator, the SBS in 2017 had a reputation for being more active than the SMV in exercising regulation. Given the importance for probity in financial institutions and for their role as institutional investors, it makes sense both that the SBS would focus on the observance of constitutive rules, and that the financial institutions themselves would want to ensure their own house is in order before exerting their influence as active investors. The Industrials category shows high coefficients.

My hypothesis is that this is because these are the firms that either have large retail brands or are supplied by large global brands with an interest in governance. Regarding IV4 and IV5, it is reasonable to conclude that high levels of local (BVL) stock market exposure

and inclusion in the BVL's investment indices brings both local and international scrutiny to those firms included in the PGI index especially since it involves at most two dozen firms. Furthermore, international financial market exposure can reasonably be assumed to bring even greater scrutiny to firms and their governance processes, and it is widely commented that international exchange rules and regulatory frameworks have been more exacting than those in Peru. For suppliers or outside investors alike, it is crucial that third parties such as independent directors, auditors and board appraisers are deployed to improve governance processes, and to increase transparency and any guarantee of fair dealing. In this light the focus on the constitutive rules over regulative rules is entirely appropriate.

The exceptional result, that IV6 has higher coefficients under M2, can be hypothesised as the result of larger privately owned groups' pursuit of economic efficiency with respect to regulative rules – it is likely cheaper to have similar administrative processes everywhere through a group to reduce the costs of set-up, processing interfirm compatibility, staff training, and staff redeployment. However, multi-country groups do not abandon constitutive rules: coefficients for IV6.4 and 5 in M2, still show statistical significance but at reduced levels to those in M1.

### **Interactions boost explanatory power and provide further evidence of equifinality**

The regression results presented above refer to the associations between four selected independent variables and dependent variables representing measures of compliance with two different rule sets. However, the independent variables may not be independent of each other. For example, the existence of overseas group structures may be more prevalent in some sectors than in others or that firms that are in the BVL GI may be more likely to seek international finance. I explore this phenomenon of interactions between independent variables in Table 5.4.

**Table 5.4: Factor interactions boost explanatory power for constitutive rules**

<b>Model and Interactions between Independent Variables (Constitutive rules only)</b>	<b>Adj.R<sup>2</sup> (%)</b>	<b>Impact (%)</b>
No Interactions – Base model M1 only as above Table 5.3	37.8	0
1 Sector and Business Model	39.5	+ 1.7
2 Sector and International Markets	39.6	+ 1.6
3 Sector and Domestic Equity	40.7	+ 2.9
4 Domestic Equity and International Markets	37.3	- 0.5
5 Domestic Equity and Business Model	39.3	+ 1.5
6 International Markets and Business model	37.6	- 0.2
All Six Interactions	<b>45.4</b>	+ 7.6
Four Selected Interactions with Positive Impact (1, 2, 3, & 5)	<b>44.1</b>	+ 7.3

Source: Author's MLR analysis of 2017 SMV data in R

The table shows the impact on the parameter measuring the explanatory power of different combinations of independent variables and their interactions - the adjusted R squared (adj. R<sup>2</sup>) - of introducing an additional interaction between all possible pairs of the four most powerful independent variable. It also shows the effect of including all six possible interaction terms in the model. The overall impact of including all six interactions is to increase the adj. R<sup>2</sup> from 37.8% in the base model to 45.4% but the bulk of this uplift in explanatory power comes from just four of the six interaction terms<sup>130</sup>.

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<sup>130</sup> To further reinforce the strength of the association between factors and firm compliance, I used the same factors and their interactions used here in linear regression to predict the compliance behaviours of individual firms regarding individual rules. Firm compliance behaviour for any given rule may be expressed in a binary manner – it either complies or not with that rule. I therefore used a logistic regression to predict the compliance outcome with actual compliance in 2020 with 11 constitutive rules for a population of 155 firms that reported in every year from 2014 to 2020. For the bulk of these rules, I was able to predict accurately the compliance behaviour of over 70% of the firms, including: the existence of a

The ability to explain nearly half of the inter-firm variance in compliance is a material improvement over the basic model. Moreover, all the interactions represent real phenomena given that they occur in corporations which experience the paired factors in their business dealings. Not only do these findings strengthen the claim of equifinality and the cumulative effect of multiple factors in combination, as illustrated in Figure 5.4, but they might also imply a synergistic effect between factors.

### **5.4.3 Conclusions from the regression analysis**

There is clearly a statistically significant explicative power for the independent variables modelled, with relatively high measures for the degree of explanation of the variance - which is made larger by including interaction terms that reflect interrelationships between IVs. These findings endorse the claim of association of the IVs with constitutive rule compliance, although a weaker effect is also apparent with regulative compliance. They also give some quantified support to the notion of equifinality involving different combinations of IVs as identified in Table 5.4. I reinforce these findings by identifying specific and plausible mechanisms in each case and, as I will show later, these support these hypotheses with testimonial evidence from case studies. However, there is a limit to how much one should promote the statistical relationships because, for a regression analysis to be empirically significant, there must be some plausibility in the notion of correlation and, by extension, in any notion of causality.

The first of the two fundamental tenets of regression is that ‘more is more’ and this does not always appear to be the case here. The 2x2 matrices for each of the independent variables with the dependent variable indicate that many cases are not ‘on the diagonal’ so

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nominations and remuneration committee 94.3%; use of internal board reviews 94%; the presence of three INEDs 75% and whether INEDs chair board committees 70%. See Appendix 5 for a fuller description.

that ‘more’ of the IV does not always mean ‘more’ for the DV. In the second of these tenets, regression assumes symmetry or reversibility, but it is challenging to interpret what this might mean empirically; in theory, a factor might be reversed, yet some of the factors are situational and so cannot be reversed and others are somewhat voluntary - for example the issuance of bonds and the exposure of the firm to the exigencies of the bond markets. What is more, if such factors were to be reversed, the institutional facts that had been created along with the associated actor functions and status indicators would be unlikely themselves to disappear. At best, there would likely be a ‘hysteresis’ effect with the gradual diminution of the culture of the new institution diminishing over time, but not necessarily brought back to the ‘starting’ point<sup>131</sup>. The addition of interaction terms into the model adds to the explanatory power, but also becomes increasingly complex as more terms are added. I therefore propose to halt the MLR work here, and discard the notion of correlative causality, and instead turn to qualitative comparative analysis (QCA). This is a methodology designed to explore the interaction and combination of multiple conditions through set theoretic methods using an alternative conceptualisation of causality based on the notions of the necessity and sufficiency of factors required to realise an outcome.

## **5.5 Exploring the nature of any causality relationships of factors**

### **5.5.1 Methods**

In this section I use QCA to establish the existence of either necessary or sufficient conditions of causality between the factors, and the dependent variable measured as either the compliance score or compliance index. QCA uses set theory in which relationships between factors - here referred to as ‘conditions’ - and the dependent variable - here referred to as the ‘outcome’ - are expressed as membership of the sets of cases representing each condition and

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<sup>131</sup> Hysteresis definition: the state of dependence of a system on its history. In economics it refers to an event in the economy that persists into the future, even after the factors that led to that event have been removed.

outcome. The relationship between conditions and outcomes in QCA is expressed in terms of the commonality between - or shared membership of - these sets. Depending on the pattern of the relationships between these sets, assertions can be made regarding the sufficiency or the necessity of the conditions for the outcome<sup>132</sup>. A particular strength of QCA is that conditions may be analysed in combinations – a parallel to the interaction analysis above - and may play a more significant role in this manner than if they were explored in isolation. There are two forms of QCA, crisp set or csQCA in which set membership is binary, and fuzzy set or fsQCA in which graded membership is explored.

I will analyse the set relationships for the whole population of corporations and use csQCA in the first instance because the difficulty of making graded judgements about 200+ corporations make using fsQCA impractical.

### 5.5.2 The importance of factors in combination

My initial exploration of the pattern of relationships between *individual* or *solus* conditions and outcomes suggests that there are unlikely to be clear necessity or sufficiency relationships at the population level, as shown in Table 5.5.

**Table 5.5: No clear evidence exists for solus condition causality.**

Y Axis: Outcome (Constitutive rules)	X axes: Individual Conditions (IVs)			
	IV1regulator	IV2sector	IV3shareholder	
<b>Compliance:</b> < average >average	0 1	0 1	0 1	-
	0 92 26	0 71 47	0 48 70	
	1 46 40	1 26 60	1 23 63	
<b>Compliance:</b> < average >average	IV4a loequity	IV4blocbonds	IV5ime	IV6busmodel
	0 1	0 1	0 1	0 1
	0 108 10	0 101 17	0 113 5	0 79 39
	1 68 18	1 69 17	1 68 18	1 47 39

Source: Author's modelling based on SMV data 2017

<sup>132</sup> See Ioana-Elena, Schneider and Thomann (2021) for a full exposition.



The table, similar in format to Table 5.2 *but with different colour highlighting*, shows two by two tables for each of several conditions and the constitutive rule compliance outcome denoted as ‘0’ for below average and ‘1’ for above average, using 2017 data for the 204 BVL registered companies not in liquidation. These tables indicate that *for individual conditions acting in isolation*, there are no clear cases of necessity or of sufficiency of conditions. A solus necessity causality would be indicated by very low figures in the  $x = 0, y = 1$  cells here denoted in blue. Similarly, solus sufficiency would be indicated by very low figures in the  $x = 1, y = 0$  cells (here denoted in red). The conditions reflecting finance – IV4a, IV4b and IV5 show the lowest scores (10, 17 and 5 in red, lower row) indicating possible sufficiency but these conditions show a small population in the  $x = 1$  column overall (28, 34 and 23 respectively) and so are likely not statistically meaningful. These findings are not surprising given the strong association between the number of incentives and overall compliance noted on the section on regression. In the csQCA analysis I will therefore be exploring combinations of conditions designated either SUIN<sup>133</sup> for necessity causality, or INUS<sup>134</sup> for sufficiency causality.

### **5.5.3 Identifying sufficiency causality in combinations of factors**

I will explore the conditions for sufficiency first, then for necessity, because the analysis of sufficiency yields more promising results. There is a plausible argument that there are multiple INUS conditions showing sufficiency causality, but there is no case to be made for the existence of necessity-type causality.

#### **Sufficiency can be demonstrated in multiple small groups of firms**

Exploration of sufficiency under INUS combinations of conditions involves the search for a *combination of conditions in intersection that are contained by the outcome set*.

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<sup>133</sup> SUIN refers to a condition that is a sufficient part of a bundle of conditions that is itself insufficient but necessary for the outcome.

<sup>134</sup> INUS refers to a condition that is an insufficient but necessary part of a bundle of conditions that is itself unnecessary but sufficient for the outcome.

As more conditions are explored the intersection of their membership becomes smaller and thus the likelihood that it will be contained in the outcome set increases. I show the initial findings for a restricted set of conditions and a parsimonious minimization process in Table 5.6. There is an overall solution comprising three possible INUS bundles of in each case two conditions in each case, which are sufficient for the for higher-than-average compliance, albeit for a limited number of cases.

**Table 5.6: Three INUS models prove sufficient for a positive outcome**

**Overall solution:** Sufficient conditions for higher-than-average constitutive compliance are provided by the following model:

[H2n AND H4locequity] OR [H4locbonds AND H5ime] OR [H5ime AND H6busmodel].

Alternative Sufficiency Models		Evaluation Criteria		Number of firms (Identity available)
		Inclusion (inclS)	Coverage (covS)	
1	H2n AND H4locequity	0.909	0.116	11
2	H4locbonds AND H5ime	1.000	0.058	5
3	H5ime AND H6busmodel	1.000	0.047	4
Overall Solution (Model 1 OR Model 2 OR Model 3)		0.994	0.198	18

Source: Author’s modelling based on SMV data 2017

The table is headed by the equation for the solution comprising three INUS expressions linked by the OR<sup>135</sup> operator, each involving two conditions linked by the AND<sup>136</sup> operator, with more detail on the three models given in the body of the table. The OR operator indicates that any of the three expressions may suffice to produce high constitutive compliance. Columns two and three contain evaluation criteria and column four contains the numbers of the cases that have the given combinations of conditions.

<sup>135</sup> A ‘+’ sign

<sup>136</sup> An ‘\*’ sign

The three alternative models are as follows: **Model 1** reflects the experience of 11 businesses – situated in industrials or financial services sectors AND having a large local equity presence; **Model 2** has five cases – having a local bond issue AND a presence in international financial markets; **Model 3** with four cases – having a presence in international financial markets AND being part of regional or international group.

A priori, these INUS models have a rational practical interpretation. Each model implies that the combination of two conditions is sufficient for a handful of firms to have a higher-than-average compliance with constitutive rules and represents either the combination of a situational condition (industry sector or business model) with a financing condition that exposes the firm to demanding investors or a combination of two such finance markets. They are also evidence of equifinality, because each model is distinct yet yields the positive similar outcome. This finding is not inconsistent with the earlier finding that there positive returns to combinations of four or five conditions above three conditions. Further experimentation with the boundary conditions may yield more complex INUS combinations.

### **Interpreting the csQCA findings**

Models for sufficiency are typically evaluated on the basis of three metrics: the parameter of fit consistency or inclusion score (*inclS*) ; this measures the consistency of fit between the superset – here the outcome - and the disjunction of INUS conditions ( [Ioana-Elena, Schneider and Thomann 2021:91](#)); the simultaneous subset relation measured by *PRI*, though this can be ignored for crisp sets ([Ibid: 93](#)); and the empirical relevance which is a measure of how much of the outcome set is explained by a particular sufficient INUS solution ([Ibid: 96](#)). Here relevance is measured in two ways denoted by coverage (*covS*).

The inclusion scores (*inclS*) for all three models measured by the inclS metric are high at 1 and 0.909. However, the coverage scores are relatively low in the range 0.037 – 0.116 indicating that the sufficiency disjunctions only explain a small proportion of the cases

displaying the outcome, and so are empirically not very relevant. Similarly, the solution coverage *covS* for the combined model at the foot of the table covering all three models combined is low at 0.198 suggesting that the model does not explain all the case memberships in the outcome – this is confirmed by noting that only 20 cases are referenced in the solution table from a potential total of 90 cases exhibiting constitutive compliance scores above the mean compliance score of 18.

**Necessity can be demonstrated but turns out not to be empirically useful**

Exploration of necessity under SUIN combinations of conditions involves the search for a *superset of conditions that contain the outcome set*. Using the outcome threshold set at the average compliance score for constitutive rule compliance, there is one finding as I show in Table 5.7.

**Table 5.7: Necessity can be proven but is not material**

Necessity Model	Evaluation Criteria		
	Inclusion (inclN)	Relevance (RoN)	Coverage (covN)
H2n OR H4locequity OR H5ime OR H6busmodel	0.919	0.416	0.520

Source: Author’s modelling based on SMV data 2017

This indicates that the superset set comprising membership of industry sector defined as industrials or financial services OR<sup>137</sup> a major presence in the local equity markets OR a presence in international financial markets OR being part of a regional or international represent a necessary condition for a higher-than-average outcome for constitutive compliance. As noted, each of these four conditions is a sufficient but not necessary part of

<sup>137</sup> The nomenclature of QCA follows Boolean conventions: the logical statement ‘OR’ is represented by ‘+’ and the logical statement ‘AND’ is represented by ‘\*’. See [Ioana-Elena, Schneider and Thomann 2021: 50-59](#).

an insufficient but necessary bundle of conditions (SUIN). Since each of the conditions in isolation does not display the characteristics of necessity, the actual necessary combinations involve two or more of the conditions in combination rather than any one of them.

For this combination of conditions to make sense it must first be subject to interpretation at a higher order than reflected in the individual conditions. A necessary condition of high compliance with constitutive rules is that the corporation must be exposed to a combination of conditions, or exogenous incentives, to provide the necessary motivation. At its simplest, this is a form of threshold concept where multiple conditions are required in combination.

Next, the model must be evaluated in terms of numerical parameters that refer to the process of constructing the superset and the relation between this and the condition set. Models for necessity are typically evaluated based on three metrics show in the three columns to the right of the table. The first is the consistency of fit with the superset of conditions measured by *inclN*. For crisp sets, this should ideally be 1 but at least pass the conditional minimum threshold of 0.9; the value here of 0.919 in the table passes the threshold but indicates that there are cases that display the outcome without displaying the alleged necessary conditions (Ioana-Elena, Schneider and Thomann 2021: 69). The other two metrics assess empirical relevance as measured by two means – relevance of necessity (*RoN*) and coverage necessity (*covN*). Coverage refers to the relative sizes of the condition conjunction and the outcome set. The lower the coverage value, the more the alleged solution is deemed to be trivial. Relevance of necessity measures the relationship between the combination of conditions and the set of cases excluded by this definition. That is, whatever the relative sizes of the conjunction and the outcome set, if a large proportion of cases are excluded, the alleged solution becomes less material. In this case both *RoN* and *covN* are relatively small implying that this solution is not especially meaningful.

The solutions derived above for sufficiency and necessity represent analytical models that lack significant empirical relevance in that they cover only a small proportion of the outcome set of cases and so do not provide a *full* explanation of the outcome, they merely provide an explanation for some component of the outcome. However, the form of the solutions also provides intuitively convincing descriptions of combinations of conditions that relate to the outcome and confirm the view that equifinality is a strong feature of how this institution has evolved.

#### **5.5.4 Further analyses**

To explore the sensitivity of the above results, I conducted three tests. First the negative outcome, that is, to define the conditions of necessity and sufficiency leading to a negative outcome in the dependent variable i.e., low compliance, but in this case such a solution reflects the absence of the IVs identified so would be meaningless. Second, since QCA is normally perceived as a ‘medium’ range N analysis, I explored the technique using 20 cases with the most extreme variation in the dependent variable. The results were not significantly different from the full caseload analysis. Third, to explore INUS relationships further I experimented with fsQCA using the case study corporations about which I had more information. This allowed me to accommodate more finely graded judgements about set membership regarding a more extensive list of conditions than would be possible under csQCA for the whole population of cases. The results were not materially different from those presented above. This was not surprising given that the cases were selected for serve Bayesian process tracing protocols, and to represent a wide array of circumstances for maximum information value. This contrasts with other sampling protocols which would be based on positive, i.e., high compliance, outcomes. With such a heterogeneous sample, I do not expect convergence around a small number of INUS or SUIN combinations of conditions.

### 5.5.5 Conclusions from the csQCA analysis

My rationale for using QCA is that correlative relationships between individual IVs and the DV are not likely to be evident nor meaningful, despite clear associations and the overall high variance explained in the MLR analysis. The two-by-two analyses of dichotomised conditions and outputs show that single conditions are unlikely to provide either necessary or sufficient conditions for the outcome, i.e. a higher-than-average compliance score. This implies that QCA might yield combinations of conditions that might be necessary or sufficient for the outcome through either SUIN or INUS respectively. The Sufficiency model for the full complement of corporations identifies three alternative INUS bundles of conditions which are sufficient to have higher than average compliance with the constitutive rules. Each of these alternative models are bundles of two condition sets: either an intersection of Sector *and* local equity, or an intersection of Local bond issuance *and* international financial markets, or an intersection of International financial markets *and* international parent. The Necessity model for the full complement of corporations identifies a single SUIN union of four of the conditions, that is membership of a superset comprising one of the following four conditions: either it operates in the financial services or industrials, or it has a significant position in the local equity market, or it has exposure to international financial markets, or it has an international parent company. Each is a necessary condition for a higher-than-average compliance with constitutive rules.

These results are interesting because they reiterate the importance of the financial markets in providing sufficient conditions for a firm to have a high level of compliance with constitutive rules, and to therefore to be more open than average to the inclusion of third parties in the firm's governance. Indeed, the very notion of seeking external finance is an act of opening the corporation to outside participation and is a break with earlier business models characterized by the self-contained family *grupo* with its own bank and tightly held equity.

Clearly other conditions are important such as sector and business model since they appear in the solutions, but the financial markets appear to predominate in their influence on corporate governance. The results also emphasise the existence of equifinality in the processes that lead to higher-than-average levels of compliance with constitutive rules. Each corporation deals with its own idiosyncratic circumstances and come to the same conclusion: that it is in their interests for them to achieve higher rather than lower compliance with the code.

## 5.6 Conclusions

The analysis provides a population level understanding of the adoption of the governance code, that is, it provides a description of how firms have responded at the population level, and of mean levels of compliance, variances, and trends. The analysis also shows that some firms appear to take the topic of governance very seriously, and that there is an upward trajectory. However, the analysis also provides key insights confirming three of the four components of my initial theory set out in Chapter 2.

First, it confirms the crucial distinction between constitutive and regulative rules for Peruvian corporations reflecting the legacy of exclusion and hierarchical capitalism, but also shows the progress that is being made, both to increase compliance with constitutive rules and to open the process of governance to a wider participation.

Second, all three modules of analysis confirm the initial hypotheses that there are several factors, whether they are called ‘agentive functions’, ‘independent variables’ or ‘conditions’, which are associated with higher levels of compliance, especially with the constitutive rules. This is an important issue for the traditionally exclusionary characterisation of Peruvian capitalism. Neither analysis represents a perfect ‘fit’ for the data – basic analysis identified the variance, the MLR produced what is a very high level of explanation (45%) of the variance - if interactions between independent variables are taken into account - but without much evidence that there were true *correlative* relationships, and



though the csQCA produced models for sufficiency and necessity that appeared to be plausible conceptually, they were only barely empirically relevant. However, the analyses confirmed the importance of two endogenous factors, industry sector and business model, and emphasised the importance of exogenous factors such as participation in local and international bond and equity markets. The influence of financial markets for those that participate is a further illustration of the opening of corporations to the wider international business culture and of a possible waning of the legacy model of hermetically self-financing hierarchical capitalism.

Third, all analyses suggest clear evidence for equifinality; that is, there are multiple different combinations of agents and their functions providing reasons for why firms should decide to comply with the various component rules in the governance code. This underscores the dispersed nature of governance as an institution.

Fourth, the analysis of year-on-year growth in compliance, particularly for constitutive rules that are changing the traditional ‘game’ of corporate governance - suggests that the question of corporate governance is a very live issue for firms and is in a state of ongoing consideration by corporate boards. The 2014 – 2016 surge in mean compliance may suggest that firms must work through a deliberate process before they acquiesce to aspects of a new governance code and that the voluntary nature of the code provides them with this flexibility.

These conclusions provide important insights into the patterns of compliance across the population of corporations registered on the BVL with a focus on the outcomes rather than underlying motivations. They confirm the association of factors with compliance, show that factors operating cumulatively, that combinations of factors are sufficient for high compliance and that there exists equifinality. Prima facie the analysis does not clearly determine the mechanisms in play – the associations I identify could be the result of

economic incentives which companies evaluate through cost/benefit analysis or could be manifestations of the multiple ways in which companies could be seeking legitimacy. I resolve this dilemma in the next chapter by exploring the attitudes of corporate leaders towards the 2014 code and examining their motivations and the influences on corporate decision-making.

## Chapter 6      Tracing corporations' responses to the 2014 code

### 6.1      Introduction

I present here a small-N sample of corporations that exhibit a range of circumstances to understand their decision-making regarding the governance code and to explore the role played by the three explanatory hypotheses set out in Chapter 2.

The basic research methodology combines investigation of documentary evidence from corporations' annual statements and reports to the SMV with depth interviews with executives across a range of roles. Some of the findings from the interviews have already been incorporated into earlier chapters for example on the development of the institutional ecosystem in Peru, as well as into the quantitative analysis through the identification and use of potential independent variables/exogenous financial incentives/conditions. I have used a form of process-tracing known as Bayesian Process Tracing ([Fairfield and Charman 2022: 405 - 410](#)). This differs from other forms of process-tracing, which are, in the main, aimed at validating a particular and central hypothesis regarding decision-making. I have selected Bayesian Process Tracing first because it is intended to highlight evidence that will enable me to make a judgement between rival hypotheses based on an evaluation of the likelihood ratios of the evidence appearing under a pair of hypotheses; it is not an attempt to prove or disprove any given hypothesis. Second, this approach is better suited to a circumstance in which I expect to see evidence supporting all three hypotheses under investigation. Third, this approach is better suited to the complexity of decisions made by multiple people about the independent adoption or rejection of 88 rules over a seven-year period. I have also used Bayesian Inference to inform my judgement about the prevailing approach used in each case study corporation.

The case studies indicate that all three hypotheses, - namely legitimacy seeking, pursuit of economic efficiency and the expression of corporate power, are in play and

relevant to corporate decision-making. However, I will show that the Legitimacy hypothesis is most associated with high levels of corporate compliance while the Efficiency and Power hypotheses are more associated with maintaining a low level of corporate compliance or with presenting an overly positive view of governance in the corporation. The case studies also provide evidence that supports a reframing of the initial hypotheses set out in Chapter 2 which I will note here. In particular, I modify the initial theory of legitimacy seeking and relate it to the groups of actors identified in the institutional ecosystem in Chapter 6 and I will elaborate on this further in Chapter 8.

In the next section, I discuss the process that I used to select case studies and then go on to set out the highlighted evidence that will enable me to discriminate between the rival hypotheses.

## **6.2 Case study selection to maximize the information value of each case.**

### **6.2.1 Introduction**

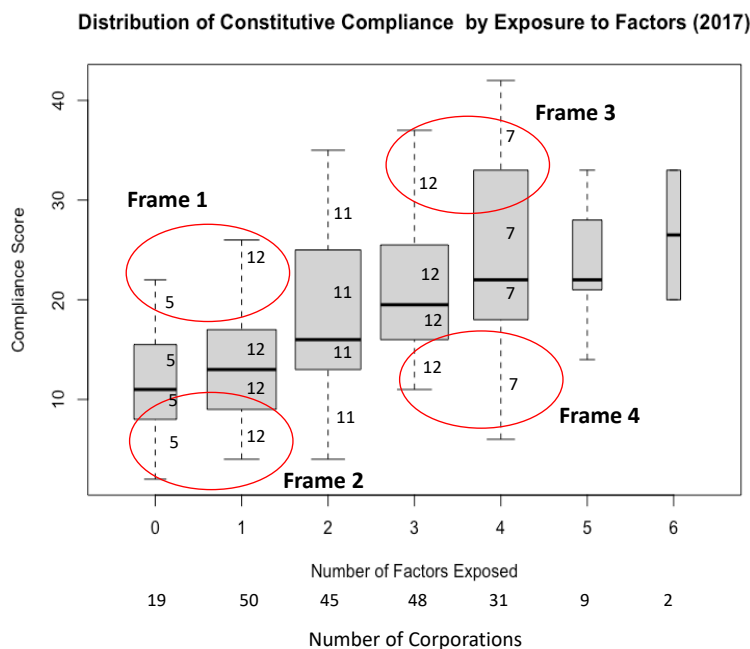
My objective for the case studies is to explore the basis of firm decision-making by exploring internally the processes deployed by corporations and externally the identities and roles of salient third-party organisations which are taken into consideration by corporate leaders. Of necessity, the case study research was undertaken in parallel with the quantitative research and the research on the eco-system with much iteration to achieve the operational coupling described in Chapter 2.

### **6.2.2 Corporate case selection**

Case study selection is an important consideration ([Seawright 2016: 81-98](#)) though in Bayesian Inference the main selection criterion is the information value of the case studies chosen rather than selecting for performance on the dependent variable ([Fairfield and Charman 2022](#)). The reason for this difference is that Bayesian Process Tracing aims to highlight evidence which yields a meaningful impact, or weight, on the likelihood ratios of

paired rival hypotheses; it is not directed at producing increasing amounts of evidence to strengthen the validation of any one hypothesis (Fairchild and Charman 2022: 405-410). From the quantitative analysis I identified two bases on which selected case studies might be especially highly information rich. First, the analysis of exogenous incentives in Chapter 5 highlighted firms which exhibit extreme measures of compliance whether they had been exposed to only a few or to several independent variables. For these firms, the quantitative analysis does not explain sufficiently the underlying variance in compliance and so they may be taken to be examples of where other factors may be influencing compliance behaviour either positively or negatively. I show in Figure 6.1 the effect of multiple incentives on compliance and use boxplots to indicate the variation in compliance for each group.<sup>138</sup> I also define four sample frames each comprising approximately 20 firms in each which I used to recruit candidates.

**Figure 6.1: Four target sample frames served to maximize information value.**



<sup>138</sup> This graph expands on the relationship between multiple incentives and compliance shown in Figure 5.6.

I have added the approximate number of firms in each quartile of the boxplots<sup>139</sup> and used this as a starting point to recruitment. I aimed to recruit corporations with especially high or especially low constitutive compliance and to include some which had either changed their level of compliance over the period 2014 to 2020 including some firms which had experienced an external shock, whether a take-over or a public scandal on the assumption that such events would enhance the information value of the Bayesian Process Tracing within the case. I confirmed that an overall sample of six to eight corporations would be sufficient to reflect both of these information rich aspects of firm behaviour and have sought to reflect these in the selection and recruiting process.

### **6.2.3 Case study research process**

I prepared the case studies iteratively drawing together documentary and testimonial evidence as inputs to a Bayesian Inference process.

First, I reviewed the corporation's SMV returns and annual accounts, including the compliance returns and the Sustainability Report, both to identify any interesting issues warranting exploration and to demonstrate a convincing case to potential interviewees that I was a serious and prepared researcher. Second, I recruited potential respondents aiming for three individuals from each corporation preferably including a full director, an independent director, and a member of the executive responsible for overseeing completion of the SMV returns regarding code compliance. Initial respondents were recruited either by introduction from third parties or via LinkedIn. Since it was not possible to control the identity of first respondents in each firm, the number and mix varies somewhat between cases. All respondents were fully briefed on the project and its objectives in accordance with the ethical guidelines and permissions sought before interviews took place. Interviews were conducted

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<sup>139</sup> Boxplots illustrate frequency distributions in four sections or quartiles: the thick line shows the median, the box contains 50% of results in +/- one quartile, the thin lines extend by +/- 1.5 x length of the box, beyond the ends of the box. One quarter of the cases from each group will be in each of the four sections.

over Zoom and recorded again by permission from the respondents. Two companies proved to be resistant to interviews.

In parallel with any interviews, I reviewed each corporation's annual reports in more detail, both to verify what I had been told and to provide further opportunities to probe issues with subsequent respondents. In addition to reviewing how corporations choose to present themselves, I developed time series of board membership and committee structures to understand what happened in practice. In the following case study reports, I have not sought to provide an exhaustive description of the corporation's governance process in the interests of time and limited resources. Rather I have used my judgement regarding the collection of evidence that is both sufficient and worth highlighting because it discriminates between the three hypotheses under investigation in line with my previous comments on Bayesian Process Tracing. Although the process tracing, evidence collection, and the Bayesian Inference process are presented sequentially, these were conducted iteratively.

### **6.3.1 Bayesian Process Tracing of case studies to highlight evidence.**

#### **6.3.1 Information value of case studies**

In this section I present the findings from the small-n case studies. The selected case studies reflect a range of businesses and circumstances and importantly, a range of manifestations of the three rival hypotheses. **Ferreycorp** is a multinational Peruvian corporation which imports heavy equipment and machinery for the mining and agriculture sectors, and which has held the agency for Caterpillar since 1960, alongside those of other global equipment brands. The firm has a very high compliance with the 2014 code. It has been influenced by a range of global branded suppliers but especially by Caterpillar. Ferreycorp is an interesting example of the power of a single individual leader to drive corporate culture over multiple decades and exhibits a high degree of reflexivity regarding governance practice. **Fondo Mivivienda** is a government owned corporation established in

1968 with a mission to offer affordable housing to the low-waged. It raises money on the bond markets to offer mortgages and finance to developers and has a crucial role in providing guarantees to other financial institutions in the mortgage market. It also actively promotes 'green' credits. The firm is seen as an extension of the MEF and is one of three public financial institutions used to effect policy. Although its parent, FONAFE, seek to improve governance standards, the fund has been slow to respond and has issues with its board composition and ambiguity over independent directors. **Compañía Minera Poderosa** is a small specialist gold-mining operation at the Marañón and Santa Maria mines with a leading market share and high profitability. The firm is owned by a small controlling group of related family shareholders with a president and executive in place continuously since the business was founded in 1962. This top group exercise very tight control over the business by way of the board, board committees and its management structure through combining the roles of President and CEO and presiding over weekly executive meetings. It has a low level of code compliance even for a listed mining company. **COSAPI** is one of the largest construction companies in Peru and works with financiers and clients on a wide range of infrastructure projects with many notable projects to its name. Originally an essentially private company with little to no share trading, COSAPI was implicated in the 'Construction Club'<sup>140</sup> scandal which came to light during the Lava Jato investigations. COSAPI took an assertive approach to cooperating with the authorities and completely overhauled the Board, senior leadership team, and its approach to governance. They now have an INED majority board including the President - though the original families still have representation - and a much-enhanced level of code compliance. **Credicorp** is one of the largest financial institutions in Peru and has four primary business divisions covering the markets of universal banking, micro finance,

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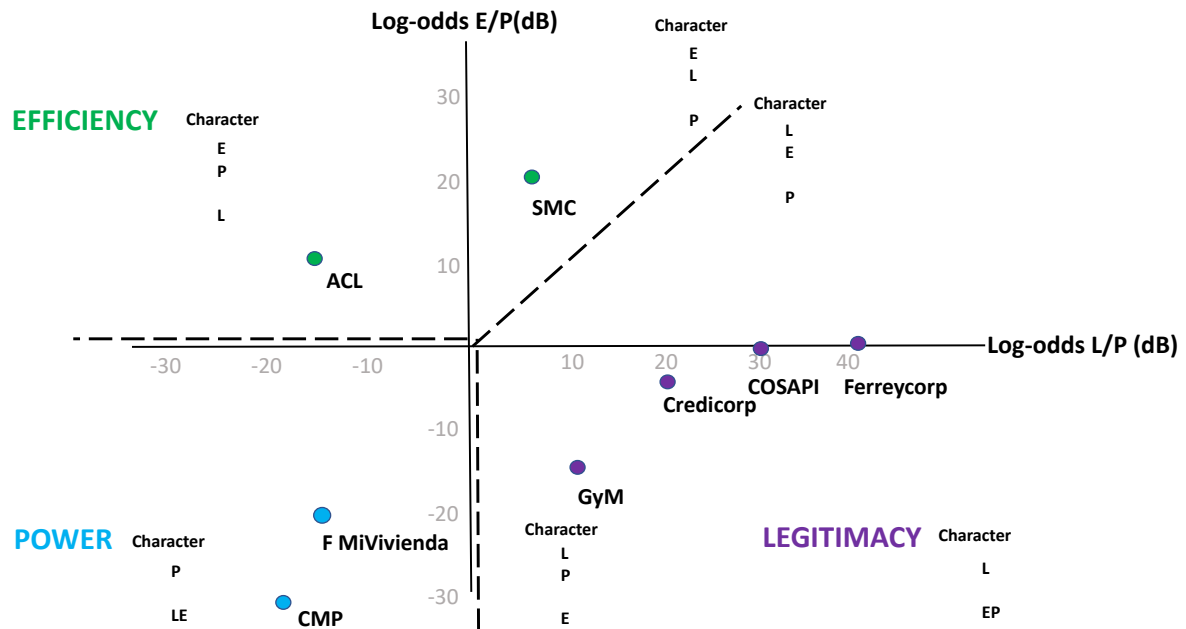
<sup>140</sup> The '*Club de la Construcción*' was a cartel of over 30 construction companies including Odebrecht, Graña y Montero, Cosapi, ICCGSA, Málaga, OAS and Andrade Gutierrez and Camargo Correa which operated 112 projects between 2002 and 2016 by coordinating tenders and eventually fined 2.76 bn Soles (US\$690) by INDECOPI the state competition and consumer protection agency ([www.perusupportgroup.org.uk](http://www.perusupportgroup.org.uk))



insurance & pensions, and investment banking & wealth management. The firm has its origins in the 19<sup>th</sup> century Banco Italiano and is now listed on the NYSE with operations in the USA, Panama, Colombia, and Chile as well as Peru. Credicorp is listed as an affiliated company to Grupo Romero and was involved in a scandal in 2019 when it was revealed that the then Chairman, Dionisio Romero admitted before a prosecutor that he had contributed \$3.65m to fund the political campaign of, amongst others, Keiko Fujimori, between November 2010 and May 2011. **Arca Corporación Lindley** is a large producer and distributor of soft drinks in Peru and has had the Coca-Cola franchise for Peru since 1999. The firm was originally established in 1910 by recent English immigrants and was taken over by Arca Continental in 2015 for which it was sanctioned by the SMV for its pricing of shares held by minority shareholders, on acquisition. Coca-Cola has a strong influence on AC Lindley's conduct, both operational because Indigenous water rights are an important issue, and on governance, as does Arca Continental. **Sociedad Minera Corona** is a small specialist silver, copper and lead mining operation which is now owned by a Canadian mining firm and operates the Yauricocha mine, Sierra Metals. SMC like other legal mining operations works with very stringent internal governance procedures in consideration of mine safety and the local communities and environment that are impacted. Sierra Metals is committed to being a low-cost producer and increasingly SMC delegates much of its governance to the parent and is run as a streamlined operational unit. **Graña y Montero**, now Aenza, was the leading construction company in Peru with a fine track record of landmark infrastructure projects. However, it was also the partner to Odebrecht in Peru and complicit in the huge corruption scandal in public sector procurement that resulted in fines, imprisonments, and the re-emergence of the firm as Aenza under hedge fund ownership. Graña y Montero is an especially interesting case because until the corruption was publicly disclosed in 2017, it had one of the best compliance records on the BVL.

These eight case studies exhibit a range of outcomes regarding the likely dominant hypothesis influencing the firm’s approach to governance, as I show in Figure 6.2.

**Figure 6.2: The case studies show evidence for all three hypotheses.**



The chart shows the log-odds ratios I concluded for each of the case studies— the x-axis is the log odds ratio for Legitimacy/Power and the y-axis is the log odds ratio for Efficiency/Power. In the lower left quadrant with Fondo Mivivienda (FMV) and Compañía Minera Poderosa (CMP), the Power hypothesis prevails; in the upper space with Sociedad Minera Corona (SMC) and Arca Continental Lindley (ACL), the Efficiency hypothesis prevails, and in the lower right space with Ferreycorp, Credicorp, COSAPI, and Graña y Montero, clearly in the space where the Legitimacy hypotheses prevails. Note that the Efficiency and Legitimacy hypotheses ‘share’ the upper right quadrant. In each space, I have added a ‘character’<sup>141</sup> reference to show the relative judgements about the rival hypotheses.

<sup>141</sup> The character symbol shows on a vertical scale the prevailing hypothesis in that part of the graph, with each denoted by its capital letter P, E or L.

To illustrate most clearly the research and Bayesian Inference processes, I present here just three case studies reflecting the three zones in the Figure and representing one each of the explanatory hypotheses. These are Ferreycorp for the Legitimacy hypothesis, Sociedad Minera Corona for the Efficiency hypothesis and Fondo Mivivienda for the Power hypothesis. The other five case studies follow a similar format and are contained in the appendix. In the subsequent discussions, I draw on all eight case studies and include evidence from all eight in the in the discussion about integrating Bayesian Inference discussion in the next chapter.

### **6.3.2 The Legitimacy hypotheses is in operation in Ferreycorp<sup>142</sup>**

In this section, I present highlighted evidence from a Bayesian Process Tracing of Ferreycorp and its approach to the governance code and reporting on sustainability. I have taken this evidence from seven years of annual reports as well as from interviews with senior executives.

#### **Background Information<sup>143</sup>**

Ferreycorp is engaged in the importation and provision of heavy specialist machinery to the mining and agricultural sectors in seven countries in the region and is the exclusive agent for Caterpillar, the US manufacturer of heavy plant and machinery along with over a dozen other global brands. Ferreycorp was established in 1922 by the Ferreyros family and partners focussed on the commercialisation of consumer goods. The firm has since then transitioned from being a family-owned group to a publicly owned corporation through major changes to its market focus, territorial footprint, corporate structure, and financing. In 1947 Ferreyros moved into capital goods through the representation of Caterpillar Tractor in Peru and by the late 1980s and early 1990s the company was focussed entirely on capital goods,

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<sup>142</sup> Also, see Appendix for case studies of Credicorp and COSAPI for other expressions of the Legitimacy hypothesis.

<sup>143</sup> All Ferreycorp annual reports referenced in this section are at <https://www.ferreycorp.com.pe/es/reportes/memorias-anales>.

assuming representation of multiple global brands. Although the Caterpillar relationship is very important to Ferreycorp, in 2019 the firm distributed 24 distinct global brands including Demag, Metso, Massey Ferguson, Chevron, Daf, Goodyear, Iveco, 3M, Cat Lift Trucks, and SEM. Since flotation in 1962, the firm has been active in the capital markets and in 2012 developed the holding company Ferreycorp. In parallel, the firm diversified its shareholding structure over time coming to comprise local investors (36%), pension funds (36%) and foreign investors (28%, mostly funds), with the Ferreyros family now owning less than 5% of the total (Ferreycorp 2019: 27, 32 - 55).

Ferreycorp is an important case study because it is an example of a firm that has made the transition away from family control, yet also illustrates the effect that a single person in a leadership role can have on the culture and governance of a previously family-owned corporation.

### **Highlighted Evidence**

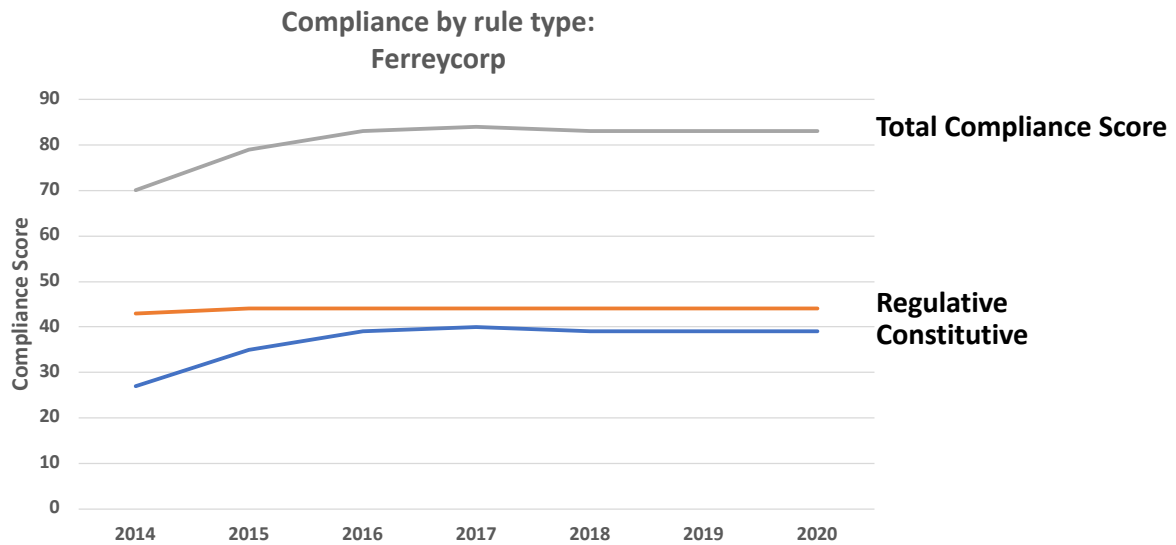
This highlighted evidence from the documentary and the testimonial research which have most information value regarding Ferreycorp's stance on governance.

When the governance code was established, respondents commented that Ferreycorp played a role in framing the 2014 code to ensure that it was 'realistic'.

*'The problem with these codes is that often, the regulator or the associations set topics for compliance when they may or may not understand how firms actually do things or how complicated it might be for a firm to do it.'* (Respondent 3)

This practical orientation was given as the explanation for the gradual increase in compliance with constitutive rules until 2016, as shown in Figure 6.3, and was attributed to establishing reliable internal processes so that they functioned well when implemented.

**Figure 6.3: Ferreycorp has maintained high levels of compliance.**



Source: Author analysis of SMV data and code

Ferreycorp provided full explanations for these early omissions under the ‘comply or explain’ arrangements of the code.

Much of Ferreycorp’s philosophy towards governance is attributed to the outgoing President Óscar Espinosa Bedoya who recently left the firm after 40 years’ service:

*‘During his management, he developed the best practices of corporate governance committing the organisation to continuous improvement and giving it a point of reference. This strategy to build a well-respected reputation for governance, strategic vision, focus on business, a great emphasis on qualified people and the values we practice makes an organisation powerful. It makes it invincible!’* (Ferreycorp 2019: 15, 16)

Espinosa Bedoya was mentioned as a major influence on the company by all respondents and is now retired but heavily involved in the anti-corruption agency *Empresarios por la integridad*. Espinosa was instrumental in developing the association with Caterpillar in 1947 and is now subject to Caterpillar’s strenuous evaluation criteria on a regular basis. The firm

emphasises its commitment to positive values and good corporate governance, and no corruption.

*‘During 2019, Ferreycorp Corporation reaffirmed its commitment to adopt the best practices of corporate governance. The Corporation is firmly committed to achieving high compliance standards and contributing to curbing corruption in the country.’*  
(Ferreycorp 2019: 12, 73)

It relates these values directly to its ongoing and close relationship with Caterpillar.

*‘Caterpillar has been active in developing a strategy with the Corporation [Ferreycorp] and especially Ferreyros [an operating company] in the electronic parts trade.’* (Ferreycorp 2019:15)

*‘This process should be accompanied by an increase in the quality of relations with Caterpillar and our other distinguished suppliers, but above all Caterpillar, whose loyalty and constant support I wish to emphasize at this time.’* (Ferreycorp 2019:13)

Executives consider Caterpillar to be very demanding:

*‘Caterpillar has its own rules of the game. So in addition to indices of good governance they [Caterpillar]) have very demanding indices of quality of service and added value so through good governance and these performance indicators we are indirectly controlling the satisfaction of the provider.’* (Respondent 1)

Yet the relationship is seen as professional and mutually respectful.

*‘Caterpillar is very respectful – we run our own business – we have an impeccable reputation and have never been involved in any form of corruption or similar in an environment as difficult as that in Peru with all its political and economic scandals. We are convinced it has to be so.’* (Respondent 1)

Ferreycorp has established several processes which have contributed to a self-perpetuating culture of good governance. The first of these is to bring in younger directors as shown in Table 6.1.

**Table 6.1: Ferrycorp’s board has progressed to shorter tenures.**

Director	App	Board Composition by Year							Years Served
		2014	2015	2016	2017	2018	2019	2020	
Espinoza Bedoya	1983	President	President	President	President	President	President	-	36
Ferreiros Aspíllaga	1971	VP	VP	VP	VP	VP	VP	-	48
Montero Aramburú	1980 93-08 VP	INED	INED	INED	-	-	-	-	36
Peña Roca	1984	D	D	D	D	D	D	-	25
Wedemeyer Knigge	2003	D	D	D	D	D	D	President	17
Defilippi Traverso	2005	INED	INED	INED	-	-	-	-	11
Bustamente Olivares	2011	D	D	D	D	D	D	D	10
Graham Aylión	2011	D	D	D	-	-	-	-	6
De Zevallos Ferrand	2011	INED	INED	INED	-	-	-	D	6
Breceño Villena	2011	INED	INED	INED	-	-	-	-	6
Ganoza Durant	2017	-	-	-	INED	INED	INED	-	4
NadalDel Carpio	2017	-	-	-	INED	INED	INED	INED VP	4
Noriega Bentín	2017	-	-	-	INED	INED	INED	INED	4
Otero Nosiglia	2017	-	-	-	INED	INED	INED	INED	4
San Martin Piaggio	2020							INED	1
De Orlando e Albuquerque	2020							D	1
Figaro de Fabbri	2020							D	1
Indep:dep		4/10	4/10	4/10	4/9	4/9	4/9	4/9	

Source: Author’s analysis of Ferreycorp annual returns 2014 - 2020

By 2017, the new structure was emerging having replaced five directors with four new INEDs leading to the departure of most of the long serving directors. The 2016 and 2020 boards have similar INED ratios but markedly different service profiles: average service of 17 years in 2016 compared with 5 years in 2020. This change was made deliberately to reduce the possibility that directors and INEDs are colluding or that long-serving INEDs have

in some way been ‘captured’<sup>144</sup> (Respondent 3). Also, to reinforce the importance of INEDs, in 2020 an INED served as Vice President, taking over the role from a veteran of 48 years.

The second more radical step is to adapt the committee structures to a new agenda and to give the INEDs presiding roles as I show in Table 6.2.

**Table 6.2: INEDs now preside over most Ferreycorp board committees.**

Committee	Estab.	Status of Committee Presidents by Year							Members
		2014	2015	2016	2017	2018	2019	2020	
Nominations, Remuneration, Corporate Governance	01 05	Director/VP	Director/VP						6
Nominations, Remuneration, Corporate Governance <u>and Sustainability</u>			-	INED	INED	INED	INED	INED	6
General Management and Strategy	01 05	Company President	Company President						6
Investment				Director	Director	Director	Director	Director	6
Audit and Risk	08 14	Director	Director	INED	INED	INED	INED	INED	5
Innovation and Systems	08 14	INED	INED	INED	INED	INED	INED	INED	6

Source: Author’s analysis of Ferreycorp annual returns 2014 - 2020

The table shows the committee structures and presidents. The President, VP and a long serving director presided over three of four board committees in 2014, with an INED presiding over Innovation and Systems presumably requiring specialist knowledge. By 2016, this had changed so that the newer INEDs presided over three of the four committees, crucially including the nominations committee indicating a reduced risk of INED capture, and the term ‘Sustainability’ was now on the agenda.

Ferreycorp has a governance team dedicated to promoting ethical behaviour, sustainability and ‘ESG’ throughout the business to create a ‘*self-propelling culture.*’

<sup>144</sup> This does not gainsay the fundamental issue with independence that directors representing share blocks may still capture INEDs through the recruitment process, but this is greatly reduced in Ferrycorp’s case because of the role of funds.



*'To have good corporate governance apart from the commitment to training and all that entails you also need to have a team that is incentivising and monitoring all the actions that have to be made to meet your objectives. There are few companies in Peru that have such a team, it is very expensive.'* (Respondent 1)

Ferreycorp have extended this approach throughout the subsidiaries and their staff.

*'... one of our goals is to ensure that what the board says regarding governance is promulgated throughout the whole company to ensure there are no pockets of fraud or parts of the company which do not comply with the code. The mechanism is to train everyone on the code of ethics and the idea is that if I don't do my job I could damage other areas of the business, and they won't get the recognition they deserve.'*  
(Respondent 1)

The firm paid special attention to constitutive rules.

*'From 2014 to 2017 we adapted ourselves to these constitutive rules in order to demonstrate how the company would perform and how it would respond to third parties and so we could reliably achieve the maximum level of compliance with the code.'* (Respondent 2)

Since the flotation in 1962, Ferreycorp has identified a need to present itself as an attractive vehicle to investors, especially AFPs.

*'We have the highest participation of AFP investment on the BVL – 35% compared with Cementos Pacasmayo with 20% and ASEM with 24%.'* (Respondent 4)

It has also accepted onto the board an AAFP-appointed INED.

*'The AAFP wanted to take the process of governance seriously and they commissioned a head-hunter to find an independent director to represent them with a particular experience and to avoid bias and be meritocratic.'* (Respondent 1)

The flotation brought Ferreycorp into contact with external financial markets.

*'Our flotation and later capital raising were to convert Ferreros into a company no longer family owned but open through the stock market to shareholders, institutional investors and investment banks.'* (Respondent 2)

However, it was bond issues rather than the flotation and listing that had most impact on governance.

*'The first bond we issued in the 90's for 5 million dollars was the first time we really encountered corporate governance. Now we have a diffuse shareholder group and no single owner, no family Ferreyros. We now have processes to deal with all types of shareholders with all types of question and, for us, the [2014 governance] code is a practical guide or a mechanism for how to manage shareholders.'* (Respondent 3)

This was Coupled with the recognition that the firm needs to be ready to raise new funds in the future, a task for which the INEDs play a role.

*'... the independent directors understand that we have much to gain from demonstrating good corporate governance and to be a reference company because it is part of our company strategy. We need to get the company ready to raise more capital when we need it and so all the shareholders will invest more, not just to get into an index or to get good marks.'* (Respondent 3)

Respondents see good governance as an important tool to drive long term value in the business and they reject the notion of short-term cost-benefit analysis.

*'Changes in internal rules and policies are not necessarily for financial gain. We make a policy change because we really consider that we are going to comply with that rule, and it is subject to our principles and way of how we handle ourselves in the business world.'*  
(Respondent 2)

Rather, Ferreycorp positions governance in a wider sense than code compliance to include transparency, professionalism, anti-bribery, interested in sustainability and ESG, which are important and ongoing tools to attract institutional investors.

*‘Good governance is a useful tool to demonstrate transparency and shows the management working to a professional framework. We see good corporate governance as a tool to attract foreign investment because the reason for the business is to add value to our shares and to benefit owners of those shares.’ (Respondent 2)*

Ferreycorp also recognises the role of Judgement Validators to aid its positioning with Evaluators.

*‘On compliance, we are in the process of applying for ISO37001 (anti bribery) for 5 of our subsidiaries with the idea of including all subsidiaries in Peru and abroad. This is not just for compliance but to have a series of certifications which will enable us to show ourselves as a firm that is interesting to invest in.’ (Respondent 2)*

Ferreycorp has a reputation for being the leading firm in Peru for governance and actively seeks the approbation of an extensive list of judgement validators. Such validators set standards of corporate behaviour on various dimensions of corporate activity and reports on how these values and targets are reflected throughout the business. These include the UN’s Ten principles of UN Global Compact and the UN’s 17 Sustainable Development Goals (SDGs), both of which Ferreycorp uses to set business goals (Ferreycorp 2019; 83, 85); the Dow Jones Sustainability Index for MILA/Allianza del Pacifica in which, for the third year, Ferreycorp is one of 57 companies, only five of which are Peruvian; and the BVL Good Corporate Governance Index (IBGC) [est 2008] of which Ferreycorp has been a member for 13 years and which gave Ferreycorp an award for its corporate governance (‘The BVL Key’) for seven consecutive year (the entrants submit their *memoria* to an external auditor for

validation). Ferrey corp is also active in the Companies Circle (est 2005) and the the Latin American Round Table policy group, is ranked third best ranked for corporate governance in Peru by La Voz del Mercado and has multiple awards for individual subsidiaries from Peru2021/PeruSostenible. It was and selected as one of the ten most admired companies (*Empresas más admiradas*) in Peru by PWC/G de Gestión: for the eighth year running, and receives frequent approbation from suppliers, in particular from Caterpillar.

### **Judgement on Weight of Evidence for pairs of hypotheses**

With regards to the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence is very implausible in the world of the Efficiency hypothesis. There is no evidence either documentary or testimonial, which suggests a short-term focus on cost-benefit calculations, the company consistently builds value for the long term. In the world of a firm seeking to use compliance in a self-serving or even manipulative way the evidence gathered here would also seem to be very unlikely to exist. The recently departed President started a process in which governance was taken as an important topic in its own right, and made this a part of the business in an authentic manner. I therefore rate the Weight of Evidence to be neutral as regards favouring  $H_E$  over  $H_P$ <sup>145</sup>, that is, 0dB to reflect the lack of any discernible difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, all the highlighted documentary and testimonial evidence all speaks in support of a world of legitimacy seeking. Ferreycorp corporatized before the introduction of the code and has sought a prominent reputation for its governance with apparent good faith, and this is widely recognised by other observers. Ferreycorp seeks legitimacy from three main audiences: Caterpillar along with other global brands concerned about their reputation, the NYSE, international bond markets

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<sup>145</sup> Denoted  $\log[P(E_{Fe}|H_E)/P(E_{Fe}|H_P)]$

and the local equity market where Ferreycorp has a leading exposure. All of these are keen to ensure that Ferreycorp is a safe and well-managed investment with good governance.

Ferreycorp now appears to have created a self-perpetuating and reflexive internal culture of good compliance. As above, the evidence is very implausible in the world of the Power hypothesis. I therefore rate the Weight of Evidence in favour of HL over HP<sup>146</sup> as +40Db to reflect the very strong difference between the likelihoods.

I summarize these two judgements in Table 6.3.

**Table 6.3: The Weight of Evidence from Ferreycorp favours the Legitimacy hypothesis.**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(EFe HE)	Very Implausible	$\frac{P(EFe HE)}{P(EFe HP)}$	No discernible difference	0	0	-
P(EFe HP)	Very Implausible					
<b>Legitimacy versus Power</b>						
P(EFe HL)	Extremely Plausible	$\frac{P(EFe HL)}{P(EFe HP)}$	V Strongly in favour of HL	-	0	40
P(EFe HP)	Quite Implausible					
<b>Total Weight of Evidence from Ferreycorp</b>				<b>0</b>	<b>0</b>	<b>40</b>

\* NB. Note HP is used as the base case in each pairwise comparison

My conclusion is very strongly in favour of the legitimacy hypothesis for Ferreycorp. The highlighted evidence shows that Ferreycorp has integrated legitimacy seeking into its business strategy especially with respect to its supply chain partners and both current and future sources of finance and it promotes consistent process and values throughout its group.

<sup>146</sup> Denoted  $\log[P(EFe|HL)/P(EFe|HP)]$

In Appendix 6 I provide case studies of Credicorp, COSAPI, and Graña y Montero which I also judged to use legitimacy-seeking in relation to the governance code, but which are responding to different circumstances in their approach to compliance.<sup>147</sup>

### 6.3.3 The Power hypothesis in operation in Fondo Mivivienda<sup>148</sup>

#### Background Information<sup>149</sup>

Fondo Mivivienda (FMV) was established in 1998 as a second-tier bank to facilitate the acquisition of housing for the population in general, with special focus on lower-income sectors, granting financial products and services to qualified financial institutions (banks and others), so that they can offer low-cost mortgage loans to the public. FMV is a secondary banking institution, so is regulated<sup>150</sup> by the *Superintendencia de Banca, Seguros y Administradores Privadas de Fondos de Pensiones* (SBS). The firm participates directly in the mortgage market by offering loans and participates, and indirectly by offering guarantees

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<sup>147</sup> Both **Credicorp** and **COSAPI** are committed to high levels of compliance with the code and are engaged in multiple financial markets in a similar manner to Ferreycorp. However, there are some important additional factors which these case studies illustrate. The first is that both corporations provide examples of the impact of a scandal and how a prompt response can lead to the recovery of corporate reputation. In COSAPI's case this was a form of institutionalized corruption through what is known as the Construction Club, a cartel of infrastructure companies who took it in turns to win road building contracts with regional and local government. This collusion was justified inside COSAPI because it had been long-standing and if it had not been in operation, the low-margin road building contracts would have been unsustainable in any case. The Construction Club came to public attention during the Lava Jato investigation. COSAPI very quickly cooperated with the authorities and changed its board and senior management. They also rapidly became convinced of the value of an explicit approach to corporate governance. The result is that they recovered their business reputation with their project collaborators and have prospered. Credicorp is a multi-divisional financial services firm once in the control of the Romero family but has since professionalized. In 2011, their CEO was discovered to have made contributions to the political campaign of Keiko Fujimori. This was a more limited scandal because it involved just one person albeit very senior and using company funds. The reputational damage was slight, but it reinforced Credicorp's commitment to explicitly good governance. Incidentally, the new head of the SMV in 2019 had previously worked with Credicorp. The Credicorp and COSAPI case studies both confirm the association of the Legitimacy hypothesis with high levels of code compliance.

**Graña y Montero** was also fully committed to maintaining a high level of code compliance but in 2017 was found complicit in the Lava Jato scandal concerning corrupt dealings between 2006 and 2014. The one-year overlap with the 2014 governance code raises issues with the role that the code played in the firm's behaviour: whether the code signalled the end of bribery or that the corruption signified the futility of such a code.

<sup>148</sup> Also see case study in Appendix on Compañía Minera Poderosa for a private sector expression of the Power hypothesis

<sup>149</sup> All Fondo Mivivienda (FMV) annual reports referenced in this section can be found at: <https://www.mivivienda.com.pe/PORTALWEB/inversionistas/pagina.aspx?idpage=48>.

<sup>150</sup> Resolución SBS No. 980-2006

to other lenders. FMV has four objectives: to promote and finance the acquisition, improvement, and construction of housing, particularly for social interest; to carry out activities related to promoting the flow of capital to the housing finance market; to participate in the primary and secondary market of mortgage loans; and to contribute to the development of the market for capital. The fund is therefore a participant and facilitator of the social housing market.

The firm is one of three financial services firms owned by the State holding company *Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado* (FONAFE) along with *Banco de la Nación* - established in 1966 and representing the government of Peru across a range of markets both domestically and internationally - and *Corporación Financiera de Desarrollo* (COFIDE) which aims to stimulate growth in SMEs in line with government development policies in relation to infrastructure, economic and social development. In all FONAFE controls 17 listed companies, mostly operating in the utilities markets, along with several non-listed entities but interestingly does not own *Petróleos del Perú* (Petroperu) the state-owned oil and gas company.

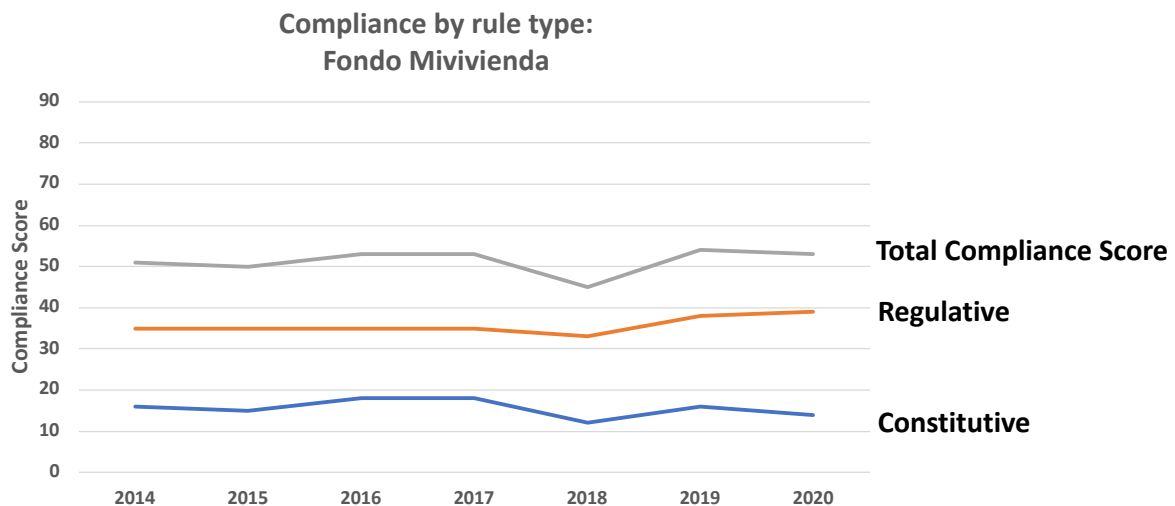
### **Highlighted Evidence**

As the state holding company, FONAFE has a role to play in the corporate governance of (FMV) and has its own parallel process to exercise influence over the code submissions of its subsidiaries. FONAFE has its own statement of Good Governance, documented in a ‘White Paper’, which is said to be stricter than the 2014 code and FMV intervenes directly in the compliance reporting process by requiring its subsidiaries to submit their reports to FONAFE for initial scrutiny and only then, after feedback including edits to the document itself and feedback on how well the subsidiary is performing, may they be submitted to the SMV ([Respondent 12](#)). However, despite the claim that the FONAFE guide is tougher than the code, FMV use the ‘explanation’ of non-compliance with the code that a

particular rule is not required by FONAFE; for example, with reference to external board evaluations (FMV 2020: 76). In any case, average compliance of the 17 group companies appears to be increasing steadily at an average of 2.3% compound or 1.2 compliance points per annum, and this growth is attributed to FONAFE’s efforts (Respondent 32).

Against this apparently improving group background scenario, FMV itself has a relatively low level of compliance with the code as I show in Figure 6.4, particularly for constitutive rules. It has not increased its compliance in line with the other group companies.

**Figure 6. 4: FMV’s compliance is consistently low.**



FMV’s compliance score hovers around 50, and the firm appears to have done little in the period 2014 to 2020 to materially improve compliance with the 2014 code other than effect modest increase in compliance with regulative rules to compensate for a slight reduction in constitutive rules. The dip in FMV’s compliance in 2018 appears to be suggestive of carelessness despite the FONAFE check.

*‘The problem was that we answered the questions but did not send the evidence to FONAFE. It was a mistake, because our system had changed there and the people who had been watching it for some time hadn't realized it.’ (Respondent 32)*

Despite this rather lacklustre performance, FMV makes a strong declaration about governance in its financial statements in recognition of its market position as guarantor of

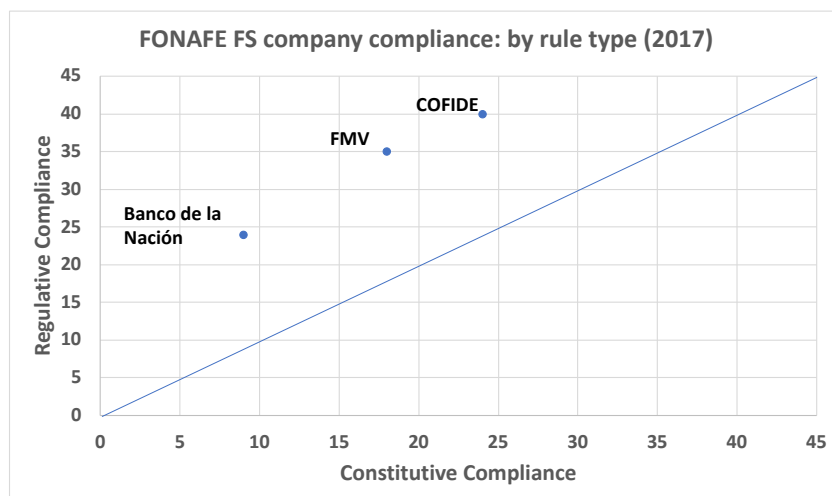


part of the Peruvian retail mortgage market. FMV states that it is ‘committed to achieving high compliance and consolidating its value reputation as a state-owned company in the private sector’ (FMV 2020: 12). It would appear that FMV is relying on its direct communications to the market to carry more weight than its submissions to the SMV.

During the year 2020, the fund continued with the implementation of Good Corporate Governance Practices - the FONAFE inspired framework - and it states that this generates value for the company, society, and its interest groups, while allowing them to be transparent in front of their investors. FMV notes that it has been incorporating both the principles that are reflected in its Code of Good Corporate Governance, according to the guidelines established by FONAFE for companies under its purview, and those principles contained in the Code of Good Corporate Governance for Peruvian Companies of the Market Superintendencia de Valores (SMV) (Respondent 12, FMV 2020: 11).

FMV is one of three financial services companies in the FONAFE group, and all play a role in policy communication, but the relative performance of these three firms shown in Figure 6.5 provides a clue to the perceived saliency of the governance code to the markets in which they operate.

**Figure 6.5: Compliance varies widely across FONAFE’s finance subsidiaries.**



Source: Analysis of SMV returns 2014 - 2020

The chart shows the compliance of COFIDE, FMV and *Banco de la Nación*. COFIDE has a relatively high and increasing level of compliance with an overall score of 64 in comprising 24 constitutive compliance and 40 for regulative. Both scores are well above average, and the overall score is increasing faster than the FONAFE group average at 4.3% compound per annum or 2.2 compliance points per annum. It operates as a development bank, so one might assume that the recipients of its funds will care little about corporate governance. However, as a large funder of SMEs, COFIDE has come under scrutiny as a lender due to the need to ensure that it is supporting ethical and not environmentally damaging businesses. COFIDE must therefore be explicitly associated with sustainable development, and it subscribes to the UN's 17 sustainable development goals (Respondent 38). It is also noteworthy that COFIDE has INEDs that are independent – the boards of COFIDE comprises a President, Vice President, two independents and two directors appointed by the state. However, the independents were only appointed in 2021 on the recommendation of the development bank *Corporación Andina de Fomento* (CAF) which had issued a similar recommendation to FMV but appointments have not yet been made: ‘*the process seems to be very delayed, they need to be more agile*’ (Respondent 38). Until then, the MEF dominated appointments. It is conceivable that being able to show evidence for good governance could be of value. COFIDE might well be seeking Legitimacy. In stark contrast, *Banco de la Nación* represents the Peruvian government in financial transactions in both public and private sectors, and in both domestic and international markets. Its credibility will be synonymous with that of the Peruvian government and little affected by its compliance process. It is therefore not surprising that its compliance score was 33 in 2017 comprising 24/44 for regulative rules and just 9/44 for constitutive rules.

FMV provides mortgages direct to the public and it also provides a government backed guarantee to other providers in the low-end mortgage market to help poorer clients.

For both groups there is likely little interest in governance or in code compliance per se. The disparity across the three firms suggests that FONAFE has no consistent *absolute* standard of governance but rather exercises a contingency model of doing what is required to satisfy each market.

The political control exercised over FMV is apparent in its board and committee structures. Fondo Mivivienda is not only controlled by FONAFE, but it also comes under the direct influence of two government ministries, the *Ministerio de Economía y Finanzas (MEF)* and the *Ministerio de Vivienda, Construcción y Sanamiento (MVCS)*, and these entities nominate FMV's directors. During 2014 – 2020, the fund operated with just five directors, a low number by Peruvian norms - four of which were appointed by the MEF and one by the MVCS, so there is a question about the role of directors in policymaking ([Respondent 40](#), FMV 2020: 7)

Traditionally, FMV had operated with a very small board – just three directors – but the board appointment process changed in 2016, with an increase in the number of directors, from three to either five or seven. However, this increase occurred alongside a reduction in the tenure of directors from five years to one year with some staggering of service periods to provide a measure of continuity from one cohort to the next. Of the 24 directors appointed to serve on the board of FMV, 16 directors served for only one year as I show in Table 6.4.

**Table 6.4: FMV’s director tenure has been falling since 2016.**

Dir. Ref.	Year										Years Served
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
1	27.09	Reapp.	Reapp.	Reapp.	Reapp.						5
2	12.12	Reapp.	Reapp.	Reapp.	Reapp.						5
3	12.12	Reapp.	Reapp.	Reapp.							4
4					02.04						1
5						03.10					1
6						03.10	Reapp.	Reapp.			3
7						03.10	Reapp.	Reapp.			3
8						09.09	Reapp.	Reapp.			3
9						18.05	Reapp.	Reapp.			3
10							02.05	Reapp.			2
11								06.10			1
12								06.10			1
13									06/07		1
14									26/09		1
15									27/12		1
16									27/12		1
17									08/04		1
18									08/04		1
19									26/09		1
20										26/08	1
21										26/08	1
22										26/08	1
23										22/10	1
24										17/12	1
<b>Size</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>5</b>	<b>5</b>	<b>7</b>	<b>7</b>	<b>5</b>	<b>-</b>

Source: Analysis of FMV financial accounts 2011/12 – 2020/21

These changes were highlighted as a matter of concern because short director tenures were seen as disruptive.

*‘... one of the most important aspects that used to raise the alarm for me was the short tenure of directors which did not allow them to have a longer-term horizon, because if the management is constantly changing, then clearly there is no time for anyone to orient themselves.’ (Respondent 32)*

One important omission from FMV's code compliance was the absence of independent directors for the period under study<sup>151</sup> (FMV 2020:71), although there was real lack of clarity over director status. This would seem surprising, given FMV and FONAFE's stated commitment to good governance.

*'We should have independents, but there aren't any. FONAFE govern us in a very political way because the directors are appointed by the two ministries. FONAFE has a White Paper that says how FONAFE should hire independent directors for their companies and assign them to their companies, but none have been assigned to FMV.'* (Respondent 32)

There appears to be a deliberate fudging of how the INED roles are presented and defined.

*'it is sometimes claimed the directors we have are independent but in response to the question III.7: Are at least one third of the directors independents? The response provided to the SMV is: 'No, none have been appointed'. Also, one of the criteria for independence is that they should not be linked to the State, not belong to the ruling political party, and not have been proposed or appointed by a ministry, so how can that be?'* (Respondent 40)

Nevertheless, there are serious questions raised about the implications of both the appointment process and the short tenure for director and therefore board competence.

*'It's a fund that has to raise money in the capital markets, it has to manage its assets. So it requires the knowledge by any official of financial institutions and markets. In my opinion, many officials who come from a sector that is not financial, sometimes do not know very well how to manage a financial entity.'* (Respondent 40)

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<sup>151</sup> I was informed by a COFIDE INED that a process was underway to recruit INEDs into FMV. (Respondent 38)

FMV does provide information on its board committees – in 2020 they had nine committees<sup>152</sup> - but does not provide information on how these might be staffed.

Because of its central role in the mortgage market, financial prudence and ethical behaviour is rightly emphasised. For example, members of senior management are required to sign Declarations of Integrity - introduced in 2020 to express their adherence to the principles and values that govern business conduct and are committed to ensuring that the risks associated with fraud, corruption and other questionable practices will be managed efficiently ([Respondent 12](#)).

FMV has always been keen to ensure that its employees behave ethically,  
*‘All senior managers, from directors, general manager and line managers have to have an impeccable resume, not only academically, but also personally. Even we, as directors, do a complete evaluation to be able to qualify to the position of director.’*  
([Respondent 32](#))

Employees are actively engaged in the process of promoting ethical behaviour:

*‘There are training programs for everyone, not only for senior management, directors, but also for employees, covering corporate governance issues, transparency issues, sustainability, and everything related. And yes, there are channels to make complaints, to make comments, suggestion.’* ([Respondent 37](#)).

Furthermore, people are recruited in part for their values and alignment with the fund’s mission:

*‘...because it is not enough to be a good technician or a good professional, but it is also to obtain that vocation for service. I accepted this position because I have a*

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<sup>152</sup> Internal risk, audit, Special Committee on Remuneration, Asset and Liability management, Social Responsibility, Internal Control, Ethics, Health and Safety at Work, and Guarantees to BFH ([FMV 2020: 8](#))

*social commitment beyond developing or fulfilling my professional work.'*

*(Respondent 37)*

FMV established 'Green' products in 2016 which by 2020 dominated new sales and represented two thirds of the credits outstanding. These are credits granted to housing projects with a certification for sustainability covering both the construction of the building and aspects of its ongoing management such as energy efficiency. These products offer an incentive in terms of interest charges and were created in order both to stimulate the demand for housing in projects declared eco-friendly and to encourage real estate developers to invest in these projects. The plan is for all products to be green and reflect the same standards for construction and management (FMV 2020: 21).

Regarding soliciting the approval of third-party agencies, in 2020 FONAFE continued with the implementation of its Integrated Management System (SIG), which draws together three other systems: the Quality Management System, Environmental Management System, and Occupational Health and Safety System, under ISO 9001:2015, ISO 14001:2015 and ISO 45001:2018 respectively. One of the main improvements made in 2020 was the preparation and approval of the Integrated Management Review that contains information on all three SIG systems (Respondent 37, FMV 2020: 84).

However, FMV's solicitation of external approval is restricted to the operational processes covered under the ISO labels. FMV does not appear to solicit contact from external agencies lobbying for sustainability and no corruption, namely *Perú Sostenible*, *Capitalismo Consciente*, *Emprendedores por la Integridad*, and PIR were not known to respondents.

*'The truth is that this is the first time I hear these names that you mention. At no time have we associated these entities with the governance of the Mivivienda Fund.'*

*(Respondent 37)*

FMVs relatively poor - and not improving - compliance and the poor perception of its director group has a cost impact on the business because its cost of funds is related directly to its rating conferred on it by ratings agencies.

*'... corporate governance (which) is an aspect that weighs down the fund's credit rating a bit. Obviously, the fund itself is a solvent entity and has been self-sustaining over time and manages around eleven billion soles, It is still investment grade but the problem is that it could be a lot better, but we don't seem to bother about the ratings.'*

(Respondent 40)

FMV is the focus of much attention by the credit ratings agencies which have an interest in governance.

*'It is precisely an issue that we and the risk rating agencies have raised because it is a public issue, that if governance is unstable over time, it generates negative noise for the markets and tends to make our financial cost a little more expensive.'*

(Respondent 40)

There is a view internally that FMV is not managing these relationships actively by improving compliance - rather the opposite - and this seems to be self-inflicted consequence of its governance processes.

*'The main criticism of our risk classification today is that the governance of the Mivivienda Fund does not have a long-term horizon because there is constantly a high turnover in directors and that may be having an impact on these indicators that you mentioned.'* (Respondent 40)

### **Judgement on Weight of Evidence comparing pairs of hypotheses.**

On the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence would seem to be very plausible in the world of the Power hypothesis. The ineffective claims of FONAFE, the disturbance to governance of the FMV board



composition, the ambiguity of messaging around INEDs true status, and the lack of concern about the funds reputation more widely appear to be consistent with a leadership that has a political agenda and is willing to be less than clear about what is going on in reality. This evidence would not seem to be at all plausible in the world of the Efficiency hypothesis because it is likely expensive to be hiring board members fresh every year. Indeed, executives acknowledged, above, the additional costs to the business in the form of impact on its credit rating and therefore on bond rates on cost of funds. I therefore rate the Weight of Evidence to be favour of  $H_P$  over  $H_E$ <sup>153</sup> as +20dB to reflect the strong difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, the emphasis on the ethical behaviour of the fund's own staff and the interest in anti-corruption, and in process standards validations through ISO is plausible in the world of the legitimacy hypothesis. However, that is as far as it goes, because FMV does not appear to have an interest in its wider reputation for good governance, and this does not appear to be relevant for the mortgage market. There was also little evidence of reflexivity on the part of senior directors, rather the opposite – a conviction that they could behave as they saw fit. Regarding the Power hypothesis, as noted above, the evidence would appear to be quite plausible in the Power world. I therefore rate the Weight of Evidence in favour of  $H_P$  over  $H_L$ <sup>154</sup> as +15dB so as not to discount legitimacy seeking entirely but to reflect the clear difference between the likelihoods. I summarize these two judgements in Table 6.5.

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<sup>153</sup> Denoted  $\log[P(EFM|H_E)/P(EFM|H_P)]$

<sup>154</sup> Denoted  $\log[P(EFM|H_L)/P(EFM|H_P)]$

**Table 6.5: The Weight of Evidence from FMV favours the Power hypothesis.**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(EFM HE)	Somewhat implausible	$\frac{P(EFM HE)}{P(EFM HP)}$	Strongly in favour of HP	-20	0	-
P(EFM HP)	Quite Plausible					
<b>Legitimacy versus Power</b>						
P(EFM HL)	Quite Implausible	$\frac{P(EFM HL)}{P(EFM HP)}$	Clearly in favour of HP	-	0	-15
P(EFM HP)	Quite Plausible					
<b>Total Weight of Evidence from Fondo Mivivienda</b>				<b>-20</b>	<b>0</b>	<b>-15</b>

\*NB. Note HP is used as the base case in each pairwise comparison

This conclusion is strongly in favour of the Power hypothesis for FMV in preference to the Legitimacy and Efficiency hypotheses. In sum, FMV is an extension of its controlling ministries with an ability to be ambiguous at best and to misrepresent at worst. Although it clearly needs legitimacy in its own market it does not appear to extend this to the wider audience of judgement validators interested in corporate governance who might be referring to the 2014 code.

In the Appendix, I provide a private sector example of a firm operating with the Power hypothesis, Compañía Minera Poderosa (CMP)<sup>155</sup>.

<sup>155</sup> **CMP** is a medium sized privately owned mining firm established in 1960 by a family that is not only still in control of the business but from which one of the firm's founders is still President and CEO. As with Fondo Mivivienda, the firm is keen to seek legitimacy from those stakeholders it values, in this case the mining regulator and the communities around its mine, yet pays little regard to the governance code. Again, CMP prefers to present a view of its compliance with the constitutive rules that is at odds with the facts, in particular regarding the status of the INEDs and their roles on committees. Essentially the firm is controlled both on the board and in the executive by a small number of people representing the controlling families. The CMP case study also confirms the association of its expression of the Power hypothesis with low levels of compliance with the code.

### 6.3.4 Economic Efficiency in operation in Sociedad Minera Corona<sup>156</sup>

#### Background Information<sup>157</sup>

Sociedad Minera Corona S.A. (SMC) is a Peruvian mining and hydroelectric generator founded in 1993. Its primary business activity is the working of the Yauricocha mining concession purchased in 2002 from the state-owned Centromin Perú S.A.

SMC is engaged in the exploration, extraction, production and commercialization of mineral concentrate, principally silver, copper, lead and zinc, at the Yauricocha mine in Yauyos province, Peru. The firm is also involved in the production and commercialization of electric power at its Huanchor hydro, located in Huarochirí province.

In 2011, SAC was taken over by Dia Bras Exploration Inc. and subsequently by the Canadian firm Sierra Metals Inc. in 2012. SAC is now an indirect subsidiary of the Sierra Metals Inc., still held through Dia Bras Perú S.A.C., an entity directly, 100% controlled by Sierra Metals Inc. and which owns 92.33% of the voting shares of SMC (approximately 81.84% of its total assets). For its part, Sierra Metals Inc. is mining company focused on in the production of precious metals and base metals, which it obtains from its operations in Peru and Mexico. The economic group is made up of 9 operating companies in Canada, Mexico, and Peru. The bulk of the remaining shares are held by Compañía Minera Casapalca,<sup>158</sup> a mining operator with a similar origin to SAC.

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<sup>156</sup> Also see Appendix for a case study of Arca Corporación Lindley, another subsidiary which since acquisition, has had its governance affected by notions of corporate efficiency.

<sup>157</sup> All annual reports referenced in this section are at: <https://mineracorona.com.pe/archivo/informacion-de-interes/memorias-anauales/>.

<sup>158</sup> Minera Casapalca was established in 1889 operating in Huarochiri and dedicated to the exploration and exploitation of copper, zinc, silver, and lead. Originally part of Backus & Johnston, in 1919 it was acquired by the Cerro de Pasco Corporation Company, then passed to Minera del Centro del Perú (Centromin). In 1986, Compañía Minera Casapalca S.A. was constituted and eleven years later, in 1997, obtained mining concessions from Centromin Peru. In 2019 the company rebranded to Alpayna ([www.alpayana.com](http://www.alpayana.com)).

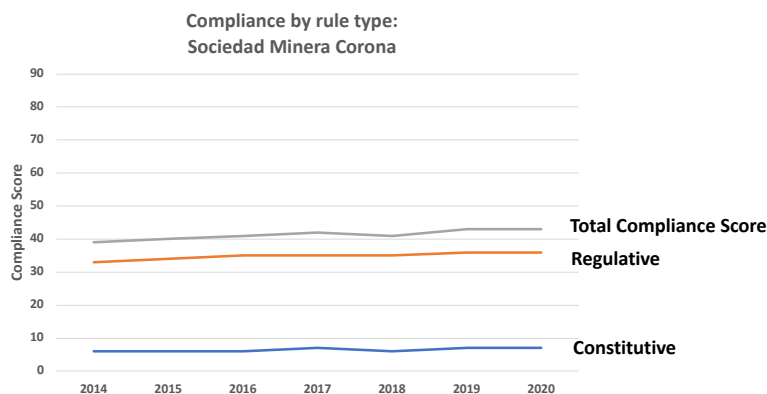
The stated mission of SMC is to support and advise the various group and contractor companies in the development of their activities, mitigating operational risks that could cause accidents, adopting international standards and practices in Safety, Health and Environment Management, and their vision is to be the safest underground mining company in Peru, ensuring that all employees fully assume their responsibility and commitment to safety as part of their activities.

SMC is of interest as a case study for three reasons: it has a relatively low level of compliance and so sheds light on such behaviour; it operates in the mining sector, one which is of great importance to Peru and concerns issues of environmental and societal management; and it is owned by an international group, which appears to have been reduced to a mere operating unit and so shows how this affects how governance matters are managed

### Highlighted Evidence

SMC has a consistently low level of compliance with the 2014 governance code particularly regarding constitutive rules; it complies with nine rules which is approximately half the average of listed firms as I show in Figure 6.6.

**Figure 6.6: SMC’s constitutive compliance is especially low.**



Source: Author’s analysis of SMV returns 2014 to 2020

Such a low compliance score cannot be attributed to its role as a mining company. There are 15 mining companies listed on the BVL, and SMC has the second lowest level of compliance. What is more, although the mining sector has a relatively low average compliance, especially compared with financials and industrials, some miners such as *Compañía de Minas Buenaventura* and Nexa Resources Peru, comply strongly with the code and are in the top 10% of firms. Indeed, *Minas Buenaventura*, the miner with the highest compliance in the sector, has double the compliance of the SMC. The seven constitutive rules with which SMC did comply with were in the main related to shareholder transparency and on average in 2017 were, on average, complied with by over 60% of companies.

Rather, SMC's low compliance is due to the nature of its relationship with its parent company Sierra Metals, and it is important to understand Sierra Metals' objectives with regard to SMC. The purchase of SMC by Sierra dramatically transformed the production profile of Sierra Metals and propelled the company from a junior exploration and development company to a mid-tier precious and base metals producer (Sierra Metals 2020). The company has invested heavily in SMC – it completed a significant operational improvement program in Yauricocha between Q3 2015 and Q2 2016, modernizing the mining methodologies, equipment, and value of ore feed to the mill, and thereby increasing production significantly. Sierra's rapid expansion in Peru was followed by the completion of the Piedras Verdes Mill in Mexico and the announcement of commercial production at the Bolivar Mine in November 2011. Meanwhile, Dia Bras has been reduced to a shell company and so has no governance resources to contribute to SAC<sup>159</sup>. Sierra Metals' objective is stated as becoming Latin America's *premier low-cost precious and base metals producer*, which it

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<sup>159</sup> Dia Bras Peru was founded in 2011 and now has just 3 employees. The firm has no operations but was used to raise capital in 2015 to raise US\$48m from Banco de Crédito del Perú. to pay SAC debts.

seeks to achieve by increasing its production profile, lowering operational costs, and growing mineral reserves and resources in both Peru and Mexico.

These bold objectives are key to understanding the governance relationship between SMC and its parent company because, in addition to seeking to improve operational efficiency by reducing operating costs, Sierra Metals is also seeking to simplify and reduce the costs of governance of SMV.

The group is in the process of simplifying aspects of its ownership structure. Both SMC and Sierra Metals are listed and traded though there has been no capital raising and there are no bonds or other outstanding liabilities. Both Sierra Metals and SMP are quoted on the BVL, and both show some trading activity, albeit at low frequency.<sup>160</sup>

Although the voting share structure of SMC is simple - majority owned by Sierra Metals, through a wholly-owned subsidiary Dia Bras Perú, with c7% owned by another miner, Cia. Minera Casapalca S.A – there is a complex arrangement of investment only shares. These shares have no voting rights which they had inherited from earlier structures. Since 2017, the firm has sought to reduce the number and value of investment shareholders in two ways. First SMC reduced the number of small retail investors with holdings smaller than 1% from 1984 in 2017 to 398 in 2019. Second, SMC made some adjustments to the 20+ shareholders with holdings larger than 1% - a participation by a member of the Graña family, Claudia Belmont Graña, in 2017 with approximately 5.5% of investment shares, was terminated by 2018, a timing coincident with the Lava Jato scandal which greatly affected Graña y Montero, Odebrecht's partner in Peru. In 2020, SMC subsequently introduced two

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<sup>160</sup> Between January 2014 and December 2020 Sierra Metals shares were traded on 117 of the available 1726 trading days with a total value of stock traded of just c4.9m Soles (cUS\$1,3m). SMC has two listings. Its listing with voting rights, MINCORC1, was traded on 32 days to a total value of 0.96m Soles representing c50,653 shares of an issue of c31.9m. Its investment only listing, MINCORI1, was traded on 743 days to a total value of 48.7m Soles (cUS\$13.4m) representing 2.6m shares of a total issue of c4.1m.

new shareholders: the Rainbow Fund LP, a US-based investment fund set up in 1982, and a new private investor related to an existing shareholder. These changes would have had a minor impact on costs though perhaps the exiting of the Graña family connection would have had a reputational value.

More significantly for cost reduction, during the period 2014 to 2020, SMC reduced the overall size of its directorate, already small by Peruvian standards as shown in Table 6.6.

**Table 6.6: SMC has reduced an already small board with no INEDs.**

Director	App	Year								Years Served
		2014	2015	2016	2017	2018	2019	2020	2021	
Audra Beth Walsh	?	President								
Guillermo Kaelin	?	Director								
Daniel Villanueva	2005	Director	Reapp	Reapp	Reapp	Reapp	Reapp	Reapp	Reapp	16
Igor Gonzáles	2013	Director	Reapp	Reapp	President	President	President			6
Diego Miranda	2013	Director	Reapp							3
Herbert Fiedler	2014	Director	Reapp							2
Mark Brennan	2015	-	President	President						2
Gordon Babcock	2015	-	Director	Reapp	Reapp	Reapp				4
Ricardo Arrarte	2019						Director	Reapp		2
Edmundo Guimarães	2019						Director	Reapp	Reapp	3
Luis Marchese*	2020							President	President	2
José Fernández-Baca	2021								Director	1
Remi McLean				Tech Dir						1
Remi Rondea				Tech Dir						1
Total		6	6	4 + 2	3	3	4	4	4	

Source: Author's analysis of SMV returns 2014 to 2020

The board consisted of six executive directors, including the President. This complement shrunk from six directors in 2016 to four directors by 2019. Also of note is that one individual has served for 16 years, a long time by best practice standards though the individual is a Geological Engineer so has relevant expertise. By contrast, three of the directors served for just two years, not a long time to get to grips with the full gamut of governance issues. In addition, there are no INEDs on the board and no board committees within SMC.

SMC explicitly delegates much of its governance to Sierra Metals which has ample resources. Sierra Metals has a relatively large board with 14 members reflecting the full range of management and governance responsibilities. Sierra has an unusual board structure with multiple Vice Presidents who have specific operational responsibilities namely: VP Operations, VP Human Resources, VP Exploration, VP Legal Affairs and VP Technical (Sierra Metals 2020). Such roles are more usual on executive committees and suggests that the Sierra Metals Board is set up to assume close operational control of its businesses. In addition, the Sierra Metals Board has four independent directors which is more than three required by the Peruvian code although the INEDs are still in a clear minority to the executive directors with an INED to total director ratio of 2/7. The close relationship between the boards of Sierra Metals and SMC is reinforced by joint membership - the CEO of Sierra Metals also serves as President of the SMC board.

Sierra Metals makes little attempt to present itself to a wide audience, for example, its annual report is focussed on the financial statements and contained just 37 pages in 2020, compared with the SMC annual report with 105 pages not including the appendices on code compliance and the Sustainability Report, which added 70 pages. Sierra does publish materials on its website, and offers information on governance: for example, board



composition and committee mandates - and highlights eight of its operating policies<sup>161</sup>.

Summaries of these same policies with the Sierra metals logo appear on the SMC website<sup>162</sup>.

In parallel, SMC have robust reexplanations for their low levels of compliance with the constitutive rules and are explicit in stating their reliance on their integration into the governance processes of their parent Sierra Metals. SMC argue in their submission to the SMV that they delegate several detailed governance tasks to Sierra Metals which provides essential governance activities such as INEDs and board committees. For example, in its *memoria* to the SMV, in response to question III.7: Is at least one third of the Board of Directors made up of Independent Directors? The explanation of “No” was given as:

*‘No. These are people with different specialties and skills, that count with prestige, ethics, as well as economic independence, sufficient availability, in order to guarantee the existence of a plurality of approaches and opinions in the Board of Directors. It is worth noting that at the director level of Sierra Metals exists a committee of “Corporate Governance and Nomination of Board Members” at guideline level.’ (Sierra Metals 2021)*

Regarding board committees: in response to III.12: Does the Board of Directors of the company form committees that focus on the analysis of those most relevant aspects for the performance of the society?

*‘No. The board does not have special committees. Nevertheless, at the directory level of Sierra Metals there are various types of committees.’ (Sierra Metals 2021)*

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<sup>161</sup> Majority Voting, Health and Safety, Privileged information, Whistle Blower Channel, Code of conduct and business ethics, Sustainability, Environment, Disclosure of information, Anti-bribery and anti-corruption. along with Chemical Laboratory standards (Sierra Metals 2023).

<sup>162</sup> [www.mineracorona.com](http://www.mineracorona.com)

Regarding the audit committee: in response to III.14: Does the company have an Audit Committee that monitors the effectiveness and adequacy of the internal and external control system of the company, the work of the audit firm or the independent auditor as well as compliance with the standards of legal and professional independence? The firm noted:

*'No. The Company has an Internal Control Officer and Compliance that is in charge of the functions of internal and external control of the Issuer, who reports directly to controller company corporate company's parent company (Sierra Metals Inc.). Said Controller, in turn, reports to the Audit Committee of Sierra Metals, on whom it falls monitoring functions detailed in this question, including what refers to the evaluation of the work of the external auditing company.'* (Sierra Metals 2021)

Or independent risk management: IV.1: Does the Board approve a policy comprehensive risk management according to its size and complexity, promoting a management culture risks within society, from the Board of Directors and Senior Management to the own collaborators?

*'No. Although there is no local corporate document approved by the directory as such, yes it has a risk assessment at a corporate level that includes the Company as a Peruvian subsidiary from Sierra Metals Inc.'* (Sierra Metals 2021).

Not all of the lack of compliance is attributed directly to Sierra Metals. In response to question III.11: Does the Board evaluate objectively its performance as a body and of its members?

*'It is considered that the Board acts in good faith and complies with the obligations imposed upon it by the applicable legislation, acting diligently to achieve the objectives of the Company. The Company considers that it is enough to achieve the*

*proposed results annually to verify that the performance of the directorate has been correct.*’ (Sierra Metals 2020:129)

Such a matter-of-fact response underscores the operational focus of the business and suggests that it is without the complex decision-making processes that might call for an evaluation of board performance and decision-making. The SMC board is focussed on mining problems and consider they have the best people to do this job.

However, SMC is keen to conform to appropriate standards relating to its business and complies only with what it sees as essential codes of practice relating to safe operations and cordial relationships with their local communities. Even before the SMV mandated a Sustainability Report, in 2014, a substantial part of the annual report<sup>163</sup> (nine of 85 pages) was devoted to environmental issues, in particular the management of residues, toxic substances, surface and underground water, tailings, atmospheric emissions and dust, the monitoring & control of subsidence, and protection of the supply of drinking water supplies. A similar number of pages were dedicated to Social Responsibility and community relations including mention of a US\$97k donation to local causes, building of infrastructure such as bridges, canals, and farming land, along with assistance to local schools and colleges and health centres. The publicizing of these projects in the annual reports and social media platforms<sup>164</sup> is seen as an important part of securing good community relations. The SMC Facebook caption reads: *We do what we say, we say what we believe!* This activity is clearly a form of legitimacy seeking but does not at all concern the governance code but addresses SMC’s relationships with local communities.

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<sup>163</sup> [www.mineracorona.com.pe/archivo/informacion-de-interes/memorias-anales](http://www.mineracorona.com.pe/archivo/informacion-de-interes/memorias-anales)

<sup>164</sup> <https://www.facebook.com/MineraCorona/> has 12,000 followers. Their slogan is: *We do what we say, we say what we believe!*

SMC continued to report on environmental and social activities throughout the period 2014 to 2020. In 2016 they also produced the mandated Sustainability Report, but the format of this report is, like the code, an acknowledgement of processes and procedures, for registering accidents and measuring operational performance, and provision of technical data e.g. for annual water consumption. However, the Sustainability Report is addressed to a different audience than the local community and so lacks the immediacy of SMC's ongoing environmental and social reporting.

### **Conclusion on Weight of Evidence comparing pairs of hypotheses.**

On the first paired comparison, *Efficiency and Power*, much of the highlighted quantitative evidence - in particular the delegation to Sierra Metals, the limited board and board committees in SMC, and the absence of INEDS - is much more likely to emerge in the world of an Efficiency hypothesis rather than the world of a Power hypothesis. Clearly the actions themselves are an expression of Power, but there is nothing in the evidence to suggest any attempt to deceive or to act with impunity, nor to pretend that SMC is anything other than an efficient mining operation run by experts. I therefore rate the Weight of Evidence to be in favour of  $H_E$  over  $H_P$ <sup>165</sup> as +20dB to reflect the strong difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, some of the highlighted quantitative evidence, especially the care taken to work with the local community and the desire to separate themselves from the Graña family investor and is more likely to emerge in the world of the Legitimacy hypothesis. The firm has exhibited reflexivity regarding its governance, but this extends to the pursuit of efficiency regarding the allocation of roles

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<sup>165</sup> Denoted  $\log[P(EMC|H_E)/P(EMC|H_P)]$

between SMC and Sierra Metals. The firm does not appear to be concerned with wider recognition beyond the absolute necessities and this form of Legitimacy is not related directly to the code. I rate the Weight of Evidence in favour of HL over HP<sup>166</sup> as +6dB to reflect the discernible difference between the likelihoods.

I summarize these two judgements in Table 6.7.

**Table 6.7: The Weight of Evidence from favours the Efficiency hypothesis.**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(EMC HE)	Plausible	$\frac{P(EMC HE)}{P(EMC HP)}$	Strongly in favour of HE	20	0	-
P(EMC HP)	Quite Implausible					
<b>Legitimacy versus Power</b>						
P(EMC HL)	Quite Plausible	$\frac{P(EMC HL)}{P(EMC HP)}$	Weakly in favour of HL	-	0	6
P(EMC HP)	Quite Implausible					
<b>Total Weight of Evidence from SMC</b>				<b>20</b>	<b>0</b>	<b>6</b>

\* NB. Note HP is used as the base case in each pairwise comparison

This conclusion is strongly in favour of the efficiency hypothesis for Sociedad Minera Corona which, owing to its business and corporate structure, is being run as a mining operation servicing a price-oriented commodity market.

<sup>166</sup> Denoted  $\log[P(EMC|HL)/P(EMC|HP)]$

In the Appendix, I provide a further example of a corporation whose governance is greatly affected by the Efficiency hypothesis, Arca Continental Lindley as the result of an acquisition<sup>167</sup>.

#### **6.4 Conclusions**

I have demonstrated in this selection of case studies that all three of the rival hypotheses appear to have some role to play in corporate decision making because each has some cases in which it holds the highest weight of evidence (WoE). Of the seven case studies, three perhaps four corporations, Ferreycorp, COSAPI, Credicorp and Lindley show the highest WoE for the Legitimacy hypothesis, while two corporations, Mivivienda and CMP, appear to show the highest WoE for the Power hypothesis, and one, perhaps two corporations, SMC and Lindley show the highest WoE for the Efficiency hypothesis. Moreover, it is not possible to discount the presence of any of the hypotheses in any given corporation; there were several incidences where I reduced judgements about WoEs due to of evidence providing support for another hypothesis. However, the corporations with the highest levels of compliance, especially regarding constitutive rules, are those where the WoE clearly favoured the Legitimacy hypothesis. That is, the Power and Efficiency hypotheses appear to gain the most WoE in cases with lower levels of constitutive compliance. This conclusion makes sense: the seeking of legitimacy from external agents such as financial markets, investors, or leading global brands is predicated on the assertion

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<sup>167</sup> AC Lindley is a successful Peruvian consumer brand business operating its own Cola brand alongside a franchise for Coca-Cola which was taken over by Arca Continental. Lindley's governance had been greatly affected, positively, by Coca-Cola, similar in some ways to the influence of Caterpillar on Ferreycorp. However, since the takeover by Arca in 2016 ACL's compliance has reduced and it appears that some functions are being carried out by Arca, though the delegation is not as marked as it is with SMC presented above. Lindley are interested in Legitimacy seeking, but mainly as regards placating local communities over water rights rather than in relation to the governance code. Lindley was also involved in some minor public scandals involving the manipulations of the price of land and also of pricing the shares of minorities on takeover by Arca. Unlike Credicorp, COSAPI and Graña y Montero, Lindley blamed Coca-Cola and Arca respectively. The case of ACL also confirms the association between the pursuit of economic efficiency and modest levels of code compliance.

that governance is important to them, whether they are Evaluators or Judgement Validators. In contrast, the Power hypothesis is associated with creating an impression of good governance whether in the form of Mivivienda's ambiguity over the lack of INEDs or CMP's proliferation of pretend INEDs. The Efficiency hypothesis is associated with only doing what is strictly necessary and justifiable on cost grounds again, with two examples, for example, at SMC and AC Lindley where governance was delegated to a parent company. In both cases, the corporation will be seeking to minimize and/or exaggerate its compliance with constitutive rules rather than maximize it in the interests of a broader mission.

Regarding the nature of legitimacy seeking there are three considerations. The first is that there exists equifinality in the way corporations are exposed to a range of different influences, which are associated with high levels of compliance with the governance code. There are clear differences as well as similarities in the specifics of the legitimacy seeking pursued by Ferreycorp, Credicorp, COSAPI and to a lesser extent ACL and this means that corporations are seeking legitimacy from different combinations of third parties each of which differ in their nature, their requirements and in their expectations. For example, the financial markets were identified as providing frameworks and disciplines for establishing and maintaining high governance standards as in the case of COSAPI and ACL. Strongly branded global suppliers and partners with an interest in their products' positioning in the Peruvian or regional markets have a vested interest in the behaviour of their partners as in the case of, for example Ferreycorp and AC Lindley. And corporations' have reacted in their own manner when they have experienced irregularities or involvement in corruption such as thin the cases of Graña y Montero which essentially lost its business, or COSAPI which lost layers of executives, or Credicorp which was merely embarrassed by its President. Equifinality also exists in the different ways in which strong owners had imposed

their own views on governance either for the sake of efficiency (SMC and AC Lindley) or for presentational purposes (Fondo Mivivienda and CMP).

The second issue concerns the meaning of legitimacy and whether the way it is enacted here is the same as that imagined by the sociological neo-institutionalists or whether it has a different character. The legitimacy seeking of the neo-institutionalists described a coercive power exercised by an external agent such as an industry leader which could cause damage if not heeded. The forms of legitimacy seeking that emerge from the case studies is on a spectrum but are much more akin to the form described by Bitektine (2015), that is a negotiated legitimacy whereby the corporation had a degree of freedom of manoeuvre in which to negotiate outcomes. In some cases - such as dealing with a major global brand such as Caterpillar or Coca-Cola - it may seem that the leading brand has all the power and Ferreycorp and ACL have none. Nevertheless, Ferreycorp had established arrangements with 20 other leading brands while Lindley was a leading supplier of its own cola alongside Coca-Cola. Neither of these outcomes appears to involve a firm without options or without agency. In other cases, particularly regarding the financial markets, although some aspects of the regulatory requirements will be strict, they will be applied equally to all companies, and any financing will essentially revolve around the terms with particular emphasis on pricing. This form of legitimacy seeking is therefore negotiated between the supplier and the corporation.

Third, the case studies provide insight not only into how legitimacy might be sought but also into how legitimacy may be lost; the effective management of scandal and corruption is crucial in an institutional ecosystem increasingly tuned in to judging acceptable behaviour and legitimacy can quickly vanish and may not always be recovered. In the case of Credicorp and COSAPI, the corporations were able to act promptly and recover, although the circumstances differed. Credicorp suffered because of the actions of one important individual acting with complete impunity. COSAPI suffered because of what was described as business



as usual in a low margin business, yet one where the environment was changing so as to make old practices no longer acceptable. Nevertheless, COSAPI reacted swiftly and firmly regarding its involvement in the Construction Club and recovered. Graña y Montero in contrast was embroiled in what the US Department of Justice described as '*the largest-ever global foreign bribery resolution*' (Simon 2019), and even though it appears to have been driven by a very small group within the firm acting with impunity, the firm reacted slowly and was essentially destroyed as a consequence to be reincarnated only in a very different form.

There are authors who see scandal as a crucial driver of improved governance in Latin America (Callund, Jiménez-Seminario and Pyper 2022). I have demonstrated in the case studies that scandal certainly plays an important role whether based in institutional corruption such as COSAPI and Graña y Montero's involvement in the Construction Club or as the result of individual actions such as Dionisio Romero's donations in 2011 to Keiko Fujimori. However, the case studies also show that reaction to scandal is not the only factor affecting corporations.

The eight case studies, three of which are presented here and five in the appendix, add a rich texture to the analysis of compliance of Chapter 5. I show that the main conclusions from the analyses are borne out by testimonial evidence and although the sample is small, the documentary and testimonial evidence adds insight into the processes both within corporations and between corporations and their partners. Crucially, I provide insight into corporations' motivations, in some cases at times when the business is under severe stress.

The case studies also reveal the existence of several actors with an interest in aspects of governance which, although appearing to be sought after by corporations, do not, according to the testimonial evidence, appear to affect corporations' behaviours around compliance. So, what role might these new actors play? In the next chapter, I return to the

issue of the underdeveloped institutional ecosystem in Peru, as set out in §3.4 and I trace how there has indeed been a process of institutional development, though one not restricted to the key supportive institutions identified in ‘donor’ countries and I show how these developments intersect with corporate governance.

## Chapter 7      Tracing the evolution of an institutional ecosystem

### 7.1      Introduction

In the previous chapter, I demonstrated that corporate compliance with the 2014 code increased throughout the period 2014 to 2020, especially for the contested *constitutive* parts of the code, which introduce third parties such as INEDS, board evaluators and auditors in corporate governance. I also began to quantify the impact on corporate governance of multiple exogenous factors in combination, as well as identifying their causal character. This did not happen in a vacuum but coincided with the steady development and strengthening of an institutional ecosystem<sup>168</sup> in Peru. This emerging ecosystem was supportive of good corporate governance, not only in relation to the topics covered by the governance code itself but on a much wider governance agenda coupling Peru to several global trends in corporate environmental and social responsibility. In this chapter I will set out the principal developments in this ecosystem and demonstrate how these developments play an important role in the thinking of corporate leadership and represent an important component of an integrated model for corporate institutional change. I will show that the institutional developments in Peru during the period 2014 to 2020 not only emerged from the preferences of actors in the governance market but that they evolved in such a manner that distinct roles could be identified in the ecosystem: agents which were engaged in partnership with corporations because of their business models grew stronger in their role as evaluators of corporate performance; others keen to promote improvements in corporate behaviour provided an information infrastructure of evaluations, prizes and certifications which contributed to the judgements being made about corporations. Simultaneously, the influence

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<sup>168</sup> I use the term *institutional ecosystem* as a metaphor for a ‘biological community of interacting organisms’ to capture the unplanned evolutionary character of institutional development in this market and to distinguish it from the more usual term *institutional architecture* which implies a degree of planning and design that is notably absent here.

of the global sustainability movement and the shock of a home-grown corruption scandal provided civic society and employees with the language and courage to speak out about inappropriate corporate behaviours. In combination, this mix of new agents, and new and reframed deontic rights and responsibilities contributed greatly to the collective will to support good governance.

Peru developed very strong *macroeconomic* institutions as it emerged from the 1990s which served to deliver steady economic growth and a stable macro economy, but it failed at the time to develop similarly strong institutions in the *microeconomy* and social arenas (Wise 2003, Lora 2007, Dargent 2015). The implementation of the 2014 code may be considered to be part of the so-called second phase<sup>169</sup> (Wise 2003: 38) of institutional developments and, as noted, it was modelled along with other influences on the UK Combined code. It can thus reasonably be described as an institutional import. However, effective institutional importation depends very much on the context into which the new institution is to be grafted and the success of the initiative will be determined in part by the nature of the institutional eco-system provided by the host country. The reason for this is that successful institutions in ‘donor’ countries become so because they have institutional *underpinnings* that are adapted to the donor country’s culture and institutional context and which support the institution’s functioning, but these underpinnings may be lacking in host countries (Schrank 2020: 252).

As I showed in Chapter 2, the UK Combined Code was designed to resolve the principal-agent problem between shareholders and management of listed corporations and relied on four underpinning assumptions: the inclusion on boards of outside directors or INEDs, who were truly independent of management and could hold both the board and executives to account; active institutional investors to support the work of the INEDs;

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<sup>169</sup> The second-phase term referred to reforms that were still essential to creating a market-based development model, but which were not as easily implemented due to their potential for opposition and political conflict.

otherwise dispersed shareholders, from whom INEDs' independence could also be assumed; and hard law to fill in the gaps of protecting the rights of minority shareholders (Varottil 2020).

When Peru introduced the new code, there was no lack of institutional support. Peru's unique response to the OECD's call to improve governance (OECD 1999, 2004) was, in the year 2000, to establish Principles of Corporate Governance, in contrast to Chile and Mexico which both established comply or explain codes (OECD 2016 (c)). These principles bore a close resemblance to the later 2014 code but were merely presented as a guide for corporations and there was no obligation to report on compliance. When the 2014 code was launched, it was supported by a dozen institutions (§3.2) and ambitious objectives<sup>170</sup>, for example, *“to generate a true culture of corporate governance in Peru, which improves the perception of corporations by investors, promote business development and contribute to value creation in the Peruvian economy”* (SMV 2013).

A priori, when it introduced an adapted 'comply or explain' voluntary governance code in 2014, Peru lacked strength in each of the four institutions identified by Spira and Slinn (2013) and Varottil (2020) as crucial to the original success of the voluntary comply-or-explain model: there was no culture on independent participation on boards with only a small pool of professionals with relevant experience; the institutional investor base was underdeveloped and lacked a culture of shareholder activism; control companies were the norm with a preponderance of family ownership and other shareholders held trivial holdings; and hard law could not be relied upon to be the backstop defender of minority rights.

In this Chapter, I will set out how the institutional eco-system necessary to support a successful implementation of the 2014 code developed throughout the period under

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<sup>170</sup> Peru was alone in targeting value creation and creating a culture of corporate governance, Chile focussed on 'providing tools for investors', and Colombia on 'guiding issuers' (OECD 2016 (c))

examination. I set out these developments in three broadly parallel yet interrelated strands. These are: in §7.2, organic developments to the existing institutional framework in Peru; in 7.3, Peru's institutional response to the global sustainability movement; and in §7.4, Peru's response to the direct involvement of its politicians, public officials and corporations in the Lava Jato scandal that was exposed during this period.

## **7.2 Organic development of the institutional ecosystem**

### **7.2.1 Introduction**

In this section I trace the development of three endogenous institutions in the governance market. First, I identify the increasing scale and activism of institutional investors in the form of private sector pension fund managers, and trace some strengthening of the BVL in the bond markets although the equity market remained underdeveloped during this time. I then describe developments in the behaviour of the SMV, the primary regulator in the governance market. Finally, I identify growth in the supply-side provision of training for directors and INEDs.

### **7.2.2 Strengthening of the Peruvian and regional financial markets**

The key participants in Peru's corporate finance markets, regarding the development of corporate governance, are institutional investors in the form of the pension fund administrators (AFPs) and the Lima stock exchange (BVL).

#### **Growth in the activism of local institutional investors**

There are two forms of institutional investor in Peru: pension fund managers which grew in significance during the period 2014 to 2020, and mutual funds, which are relatively minor in scale and effect. The pension fund managers began to influence the corporate governance behaviour of listed corporations by accumulating significant assets under

management (AUM), beginning to become active equity shareholders, becoming investors in bonds issued by corporations, and promoting the principles of ESG and sustainable investment, in collaboration with other agencies such as PIR.

Peru has a dual pension system. A public system, *El Sistema Nacional de Pensiones* (SNP), was established in 1973 and involves multiple mechanisms including a non-contributory defined benefit<sup>171</sup> system along with options for individuals to make additional contributions. In 1992 a private pension scheme, *El Sistema Privado de Pensiones* (SPP) was introduced which consisted of a money purchase arrangement with individual's contributions managed in a selection of funds by private investment managers (SBS 2020).

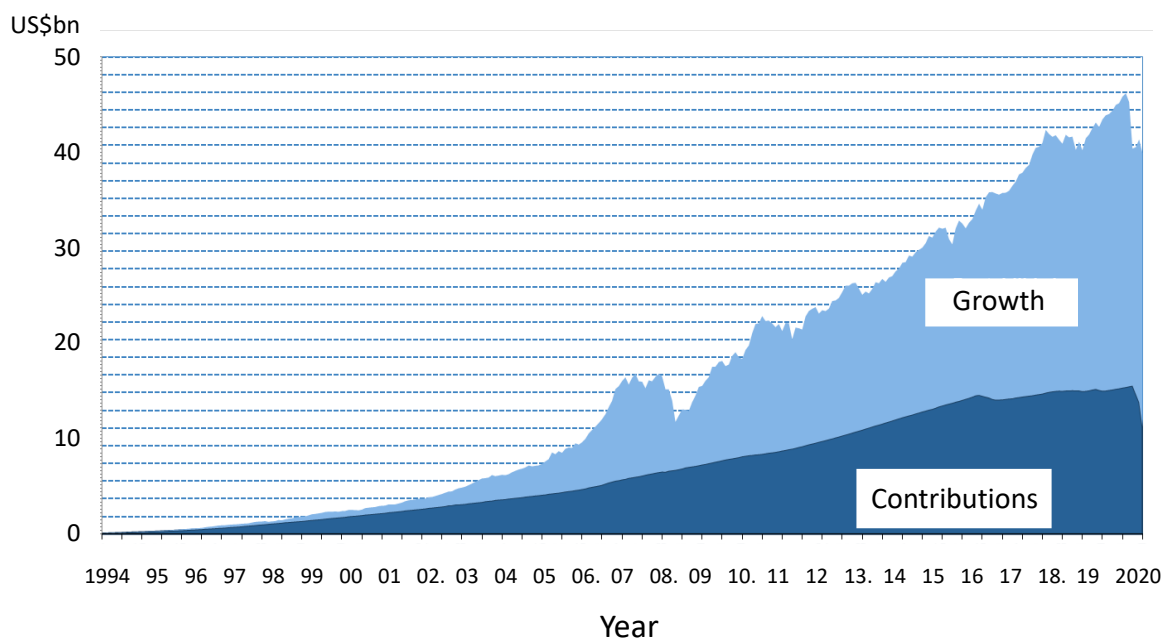
The pensions managers for the SPP, *Administradores de Fondos de Pensiones* (AFPs), were created in 1993. Originally there were eight providers but only two of the original AFPs are still operating independently and with the addition of two new entrants in 2005 and 2013, the market now consists of four AFPs, only one of which remains in Peruvian ownership.<sup>172</sup> Collectively, the AFPs have been more successful in attracting subscribers than has the public scheme; subscribers to the SPP have grown geometrically since 1993 and now number c8.5 m, significantly more than the c4.6m members of the SNP. This relative success is despite criticisms levelled at the AFPs for providing a limited selection of internally managed funds through which to invest and for charging high fees (Respondent 25) and is reflected in significant growth in assets under management (AUM) as I show in Figure 7.1.

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<sup>171</sup> A 'defined benefit' pension guarantees a level of post retirement income whereas a 'defined contribution' or 'money purchase' scheme is concentrated on specifying employer and employee contribution levels into an individual fund with no guarantee either of post-retirement income nor of the capital value of the fund itself.

<sup>172</sup> AFPs and their ownership: Integra - AFP SURA (Colombia); Prima – Credicorp (Peru); Profuturo – Scotiabank (Canada), and Habitat - Habitat (Chile).

**Figure 7.1: Assets managed by the private pension scheme doubled from 2014 to 2020**



Source: SBS - Boletín Semanal del Sistema Privado de Pensiones: Año 2020 - N° 26. (SBS 2020: 11)

The chart shows the cumulative contributions (dark blue) and market growth (light blue) in assets under management, amounting to a total of approximately 160bn Sol (c.US\$46bn)<sup>173</sup>. Although, as noted earlier, Peru’s pension funds trail those of Chile, by 2017 the accumulated funds in private schemes were still significant amounting to 22.3% of GDP with 22% of total market capitalization and 53 % of the shares available for trading due to the limited float<sup>174</sup> (Respondent 15/19).

The AFPs have their own association, *La Asociación de Administradoras de Fondos de Pensiones* (AAFP) whose stated roles are to seek continuous improvement in the pension system, help the AFPs to improve their services both collectively and individually, and to represent the AFPs before public authorities and other entities (AAFP 2022).

<sup>173</sup> For quick reference I have used the exchange rate of 3.5 Sol/US\$ throughout

<sup>174</sup> That proportion of shares available for trading, not including closely held shares.



The four mentioned AFPs were all operating during the period of operation of the governance code and are listed on the BVL as well as being investors in the shares traded on the BVL and on other exchanges. They are supervised by the SBS, the regulator for financial institutions. One key aspect of the regulatory constraints that they face is the proportion of funds which they are allowed to invest outside Peru; the AFPs seek low risk returns which are more plentiful in international markets but international investment diminishes their role as active investors in relation to Peruvian listed stocks. In 2000, AFPs were allowed to invest only 7.5% of their funds outside Peru, but this limit was raised on a total of eight occasions to reach 41.5% by 2014 and on a further three occasions to reach 50% by 2018 where it has since remained. Typically, the AFPs have invested sums internationally just 2-3% below the permitted maximum levels, and the bulk of this has been in the international financial sector (AAFP 2022).

Of the domestic investments approximately 21% is invested in Peruvian Government bonds and so the remaining c 30% of the AFPs' AUM is invested in local equities or corporate bonds. This would have equated to c Sol 50bn (c. US\$14bn) in 2018. The funds peaked in value in 2019 at Sol 173bn (c. US\$49bn) and had declined to Sol 121bn (c. US\$35bn) by 2022.

Nevertheless, the AFPs have been the major single group of investors in the BVL, holding a significant proportion of the float of the companies actively traded (Respondent 19/19). They therefore play an increasingly important role as institutional investors. Their association plays a coordinating role and so amplifies their individual actions. For example, the AAFP has been active in working with the PRI to develop a set of criteria to reflect sustainable investment and these are being used by the AFPs in their individual investment

strategies. The AAFP is also active in the placement of INEDs into certain companies<sup>175</sup>, where the combined shareholdings of several AFPs are substantial.

### **Strengthening the local stock exchange**

The BVL exerts power over the listed sector largely because of the leverage provided by listing rules, and because of the extent to which it can participate in initiatives to publicize good governance through surveys and through targeted indices highlighting selected stocks.

The Lima stock exchange, the *Bolsa de Valores de Lima* (BVL), was established in 1860 as a private company. However, like most stock markets in Latin America, the BVL never attained the same scale relative to its economy as did stock markets in the G7, and more recently, in certain Asian countries, whether measured in terms of listings per capita, total market capitalisation as a percentage of GDP, or trading turnover as a percentage of GDP. In 2004, the average market capitalisation as a share of GDP of Latin American stock exchanges was 45% of the level of exchanges in G7 economies' exchanges and 28% of those in Asian economies, while relative trading levels were even smaller at 6% and 5.5% respectively (de la Torre, Gozzi, Schmuckler 2008: 126). The structural characteristics of the BVL, shared with other regional exchanges, were set out by Vernava (1999: 237). These characteristics are the concentration of market capitalization in very few firms; the importance of international institutional investors; the lack of engagement of Peruvian retail investors; and the lack of relevance of the BVL to smaller firms in Peru. In addition, Vernava highlights a general preference for debt finance amongst corporations (Vernava 1999: 251) in part due to a legacy of holding company structures<sup>176</sup>. The BVL was at a recent peak of membership in the late 1990s with 245 listed firms, and of market capitalization in 2008/2010

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<sup>175</sup> For example, Ferreycorp has an INED appointed by the AAFP – see case study in §7.3.2

<sup>176</sup> Reference hierarchical capitalism: Schneider 2013 and Monsalve 2014

at 90% of GDP<sup>177</sup>, but since the 2008 financial crash the equity trading activities of the BVL have been in slow decline and there hasn't been an equity IPO since 2013 ([Respondent 15/19](#)).

In a review of financial liberalization in Peru, one author commented:

*'Peru's equity market is both emerging and underdeveloped within the foregoing definitions. There has been no tradition of widespread ownership of equities in Peru, and this continues to be true but to a lessening degree as a result of the privatized social security system. Nor has the equities market been significant in the financial sector as a source of primary finance, another factor that remains true for the overwhelming number of Peruvian public companies even after Peru's financial liberalizing reforms.'* ([Vernava 1999: 36](#))

The BVL appears to have reached a stable position, with a little more than 200 listed corporations plus investment funds but with both market capitalisation and trading dominated by fewer than 40 firms which comprise its benchmark general stock index, the *Indice General del BVL* (IGBVL) ([OECD 2015](#)).

The BVL has sought to increase trading in other instruments ([Respondent 19/19](#)). Peruvian corporates have developed an appetite for bond finance. Bloomberg reported on a more significant growth in US\$ denominated bonds by Peruvian corporates: these increased by a factor of 80 from \$0.2bn in 2010 to \$16bn by 2014. This demand has affected the local market for bonds which experienced a 47% increase year on year, though the constraint on local market issuance is the lack of liquidity for investors who are therefore required to adopt a buy and hold strategy ([OBG 2022](#)). A 2020 study of bond issuance on the BVL compared issues in 2005 - 2010 with those in 2015 – 2019, finding that interest rates had declined, bond

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<sup>177</sup> [Hyyps://www.theglobaleconomy.com/Peru/](https://www.theglobaleconomy.com/Peru/)

issuance had increased, and that there had been an emergence of so-called green bonds<sup>178</sup> (Zagarra 2020).

In addition, the BVL has extended its institutional reach somewhat by working closely with the SMV under a ‘Limited Exchange Self-Regulatory Organisation’ model in which the BVL shares authority to regulate trading and to supervise compliance with the market’s regulations, and it has been very active in promoting good corporate governance (Respondents 7, 19/19). The BVL has established indices relevant to governance, ESG and sustainability. In 2008, the BVL created an index to recognise companies with good governance, the *Indice de Buen Gobierno Corporativo* (IBGC) (Respondent 16). In 2017 the MILA exchanges announced an agreement with S&P Dow Jones Indices, the IFC, and RobecoSAM to develop a new ESG index for the region, with a Peru component the S&P/BVL IBGC which itself was updated in 2021. The exchange carries out ongoing surveys of market perceptions of governance, for example, in 2014, the BVL collaborated with EY to produce a survey of market participants’ views on the governance of issuers (*La Voz del Mercado*). The report now also covers the other markets in the Pacific Alliance. The exchange also made ESG reporting as a listing condition for corporations in tandem with the SMV’s resolution in 2015<sup>179</sup> requiring issuers to provide a sustainability report alongside the report on corporate governance required by the 2014 code. These were made part of the BVL’s listing rules and the BVL provided guidance on completion of the report on its website.<sup>180</sup>

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<sup>178</sup> Green bonds are conditional debt instruments tied to improved environmental behaviour on the part of the issuer with sanctions for non-performance.

<https://www.oecd.org/environment/cc/Green%20bonds%20PP%20%5BF3%5D%20%5Blr%5D.pdf>

<sup>179</sup> Resolución: SMV 033-2015-SMV/01

<sup>180</sup> <https://www.bvl.com.pe/sostenibilidad>

## **An attempt to create a regional stock market to serve the Pacific Alliance**

One important structural development intended to arrest the decline in national exchanges was the creation of the *Mercado Integrado Latinoamericano* (MILA) in 2010 in which the BVL joined with the Chilean and Colombian exchanges (*Bolsa de Comercio de Santiago and Bolsa de Valores de Colombia*). In late December 2014 the Mexico exchange (*Bolsa Mexicana de Valores*) joined MILA to form the second largest exchange in Latin America, encompassing all the countries in the Pacific Alliance. The objectives of MILA were to facilitate investment into the assets listed on the respective stock exchanges, to attract new capital and to provide more and better investment alternatives to the residents of the countries involved ([Respondent 19/19](#)). The exchanges did not merge but were united virtually, and they standardized their regulatory frameworks so that the markets could combine and thereby facilitate international transactions ([Respondent 7](#)).

Underlying the creation of MILA was the notion that the higher liquidity and lower costs of the integrated market would stimulate investment. It was seen as being consistent with the urgings of international agencies such as the Inter-American Development Bank (IADB). However, several follow-up studies have failed to conclude that the experiment has proven to be worthwhile ([Bolaños, Burneo, Galindo and Berggrun 2015](#)). This is consistent with evaluations of the AP overall; despite many promises, little has been done to promote the alliance's objectives.

MILA was in operation from 2015 to 2020 during the bulk of the period of this study of the corporate governance code, yet it was never mentioned spontaneously by any research respondents, whether market professionals or corporate executives, as playing a role in how they think about corporate governance, nor even in relation to fund-raising.

### 7.2.3 Toughening stance of the SMV

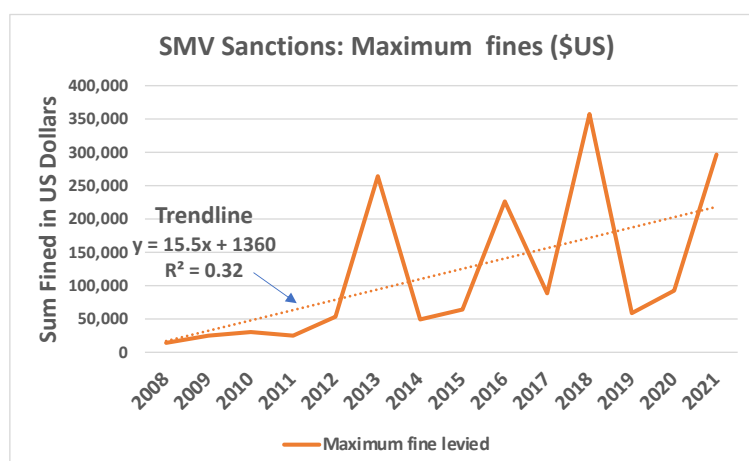
Two regulators, the *Superintendencia de Bancos y Seguros* (SBS) and the *Superintendencia del Mercado de Valores* (SMV) share responsibility for regulation in the field of corporate governance. The SBS has the power of veto over corporations operating in the financial services markets and can withdraw their licences if required. As a result, financial institutions have consistently had a higher level of compliance with the code as I demonstrated in Chapter 6. However, the SMV has implemented a series of measures to exert more influence over its charges including, in date order: tougher sanctions for corporate rule breaking; a requirement for sustainability reporting on business operations; and a clearer definition of the role of the independent director, so as to reduce misrepresentations of ‘friends and family’ ([Respondent 22/19, 23/19](#)).

#### **Tougher sanctions on governance transgressions**

The SMV assumed an increasingly active role in the regulation of corporations in respect of their corporate governance. It is responsible for the conduct of the stock market and listed companies and for managing the governance code. The SBS has responsibility for financial sector firms and for overseeing the licences awarded to firms. The SBS therefore has more direct control over the future business of its supervisees than does the SMV because it has the ultimate sanction of withdrawing a licence should it see fit. Between 2008 and 2021, the SMV issued an average of 70 sanctions per annum for transgressions of governance and regulatory rules, of which 50 carried fines (Data provided by [Respondent 24/19](#)).

Ultimately, although the issuance of both sanctions and fines declined very slowly during the period, there was a marked shift in the scale of fines levied by the SMV which periodically intensified throughout the period 2008 to 2021 as I show in Figure 7.2.

**Figure 7.2: The SMV levied increasingly large maximum fines 2008 – 2021**



Source: Author's analysis of SMV data

The chart shows the maximum fine levied in each year.<sup>181</sup> The trend line shown by the orange dots indicates that, despite the volatility, the average maximum fines increased on average by approximately US\$15,500 per annum, and more dramatically the maximum fines levied increased from just US\$15,000 in 2008 to US\$357,000 in 2018. Despite this toughening stance, I was not able to find any direct relationship between sanctions and compliance at the corporate level.

### **Tougher definition of the independent director (INED) role**

In 2019, the SMV, in conjunction with the MEF, issued new guidance<sup>182</sup> on the role of independent directors for listed companies in Peru, replacing an earlier resolution in 2011. It is noteworthy that the new document was 28-pages long, while its predecessor was just one page.

The question of INEDs in Peru is a relatively new concept and is one that is in substantial flux. For example, the SMV's document notes that there is no requirement in corporate law to have INEDs nor is it included in the norms of the SMV itself. However, there is a requirement for firms to have at least one INED, and the 2014 code promotes the

<sup>181</sup> Converted to US\$ at 3.4 Sole per dollar, the rate pertaining in 2016.

<sup>182</sup> Resolución SMV No. 016-2019-SMV/01

appointment of three INEDs, while draft legislation<sup>183</sup> to reform general company law contains reference to a minimum of five INEDs per board.

The movement towards a definition of the independent director role began in 2002 with the inclusion in the Principles of Good Corporate Governance for Peruvian Companies,<sup>184</sup> which defined independents as: *‘those selected for their professional prestige and who are not linked with the administration of the company nor with the controlling group’* (SMV 2019: 1).

The intention was to establish the role of the board as setting the strategy of the firm and for the board and the regulator to be able to rely on INEDs to exercise impartial judgement on internal matters to with respect the rights of all shareholders (Respondent 30/19). Companies were expected to state the number of INEDs on the board, to declare any special requirements they might have for INEDs, and to make a declaration that the INEDs were indeed independent (SMV 2019: 2).

The *Principles* were replaced by the code in 2014<sup>185</sup> on a comply-and-explain basis and the *Annexe of the Principles* was replaced by the legal requirement to produce detailed report on the firm’s compliance with the new code. The code was much more demanding than the *Principles*, in terms of information required about on the operation of the board in general and about the contingent of INEDs in the firm. In particular, the code required firms to have at least one third of the directorate as independents, and these selected for their *‘...professional career, sense of honour, economic sufficiency and independence and lack of connection with shareholders or directors.’* (SMV 2019: 2)

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<sup>183</sup> Article 230 of the *Anteproyecto de la Ley General de Sociedad*, a Bill to reform company law established in 1998.

<sup>184</sup> [https://www.smv.gob.pe/ConsultasP8/temp/principios\\_buen\\_gobierno.pdf](https://www.smv.gob.pe/ConsultasP8/temp/principios_buen_gobierno.pdf)

<sup>185</sup> *Resolución SMV No 012-2014-SMV/01*



The report required information on the criteria used by the company to qualify directors as being independent so that the market including investors and other regulators could be made aware of the state of the independent status of a firm's directors.

Stimulated by a need to make more specific reference to transactions with related parties and to harmonise the code with other rules on this matter, the SMV initiated a consultative process with the market, reframing the rules with respect to related party transactions and the description of the INED role (SMV 2019: 3).

The result of this process was a new set of requirements for independent directors contained in the SMV's June 26<sup>th</sup>, 2019, resolution,<sup>186</sup> which defined a wider role for the independents. The resolution noted that both the board and the independent directors have an important role in the business, since it is they who define the policies and strategies and oversight in exercising their fiduciary role for the good of society. It stipulated that all directors should have a responsibility to be well informed by management on the actions of the company and to promote good governance. Independent directors should also generate new opportunities for companies; contribute to their sustainability; allow them to differentiate themselves from their competitors to the benefit of their shareholders; and to have a short-, medium- and long-term perspective based on an internalization of best corporate practice. Corporations were also required to separate the functions of the board and management in line with the code of the *Corporación Andina de Fomento* (CAF),<sup>187</sup> and to separate the functions of the CEO and President in accord with the latest OECD guidance on corporate governance, which was produced in conjunction with the G20 (OECD 2016(a)). Directors were required to be proactive and to implement a preventative model of management to avoid criminal behaviour in accordance with existing laws.<sup>188</sup> The resolution widened the criteria

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<sup>186</sup> Resolución SMV No. 016-2019-SMV/01

<sup>187</sup> <https://www.caf.com> and for the 2013 code: <https://scioteca.caf.com/handle/123456789/555>

<sup>188</sup> For example, Law No. 30424

for board membership: all board members should be considered as people of competence, of diverse ages and genders, and with ethical principles, economic independence, and time to carry out their role for the good of society.

The thrust of these developments was to establish a wider, proactive, and more responsible role for independent board members, encompassing social responsibility, harmonisation with legislation and coordination of guidelines with international agencies. The independent directors were seen as an essential component in achieving corporate boards that could behave in this manner and in so doing, enable boards to conform to guidance provided by the OECD which requires there to be a balance of power on the board (Respondent 22/19).

The SMV took the opportunity to set out their vision for INED participation to emphasising that:

*'... the persons who form the board should behave ethically with respect for the culture of integrity which should apply to the whole organization, and this should apply to all members, not just to the independents. and without the interiorization of these principles and commitment to their achievement, little will be accomplished'*

(SMV 2019: 6).

The reference to interiorisation is worthy of note. Essentially this is a call for institutionalisation of the SMV principles and vision; in other words, the creation of new institutional facts, to use Searle's terminology (Searle1995) and a call for greater reflexivity on the part of corporations regarding governance. It does appear from this feedback that the new leadership of the SMV took a more active approach to improving corporate governance in general, the definition of independence and of the role of INEDs, and this is being perceived as such by corporate executives and other professionals, for example - with EY-operating in the field.

The emphasis is also on more demanding standards and coordination with existing hard law with the suggestion that more will follow. However, for there to be a thriving INED market, there needs to be training designed specifically to alert executive directors and other professionals to the distinctive aspects of the INED role.

#### **7.2.4 Growth of the INED and director training market**

Stimulated by the new demand for INEDs in Peru and by the more demanding definition and criteria for INEDs contained in the SMV 2019 resolution, the executive education sector has responded by offering programmes for INED training, alongside broader programmes for executive director training. One respondent estimated the demand for INED roles to be of the order of 600 for the c. 200 BLV listed corporations based on the 2019 resolution of three INEDs per board ([Respondent 35](#)).

There are three programmes involving collaborations between university business school departments and professional firms in the governance market such as executive search or accounting or advisory firms – as well as with overseas universities. These programmes have varying degrees of focus on the INED market, and they set INED training in the wider context of corporate governance and the role of the director, so target a wider audience than just prospective INEDS. CENTRUM - the business school at PUCP working with leading executive search firm Nugent & Delgado - offers a course called the *Programa de Certificación para Miembros de Directorio (MDD)*. For a fee of US\$8,500, this course consists of 48 hours of online tuition coupled with activities and workshops leading to a certificate (MDD). It targets INEDs, executive directors and senior management and claims to be the only one in the market of its kind. The programme is intended to help professionalise companies' boards of directors in Peru by training of future independent directors. It claims to meet '*a growing demand for these professionals, within proper*

*management framed in good corporate governance*'. A collaboration between the Pacífico Business School, the accounting and advisory firm EY, and Georgetown University offers the *Programa para Directores de Empresas (PDE)* which features a double certification from Pacífico and Georgetown. For a fee of US\$8,950, the PDE offers 111 hours of instruction. The programme has a wider target than only independent and executive directors to include Presidents, shareholders and owners and so is also targeting the wider family controlled private sector. Another collaboration, between the University of Piura, the accountancy and advisory firm PwC, and executive search firm AMROP, offers the *Programa de Especialización para Directores (PAD)* from the New York campus of IESE Business School, Navarr. This programme is focused on board improvement and governance with less direct focus on the INED market. The course consists of 14 weekly modules.

These courses are not focused entirely on the BVL/INED market but also include family-owned private businesses in their scope, many of which will be of significant scale. One respondent estimated that perhaps one third of the combined alumni enter into the BVL sector: or, a stock of trained INEDs in the region of 150 individuals. This is a reasonable number given the overall demand of c600 roles. There will be experienced executives who do not feel in need of training, as well as internationally experienced INEDs taking up roles. There is also the common practice of an individual having multiple roles. However, in the short term, demand may outstrip supply with a risk of over-boarding<sup>189</sup>. As one partner of a search firm commented: *'Our clients need someone independent on their board, but not one of the 50 well known people with 10 plus roles each where they will be their smallest role.'*

(Respondent 41)

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<sup>189</sup> Over-boarding refers to the practice of individuals accumulating an excess of board positions beyond their capacity to read the board packs and to make a positive contribution.

### 7.2.5 Launch of *La Voz del Mercado* to highlight relative governance performance

EY has established itself as the leading independent authority on corporate governance in the region through its publication *La Voz del Mercado* (LVdM). LVdM Peru (EY & BVL 2016) is a joint effort between EY and the Lima Stock Exchange (BVL) launched in Peru in 2014 with the goal of “*improving the quality of corporate governance in Peru by highlighting the relative performance of the leading corporations on the BVL*” (Respondent 8). LVdM received recognition from the Organization for Economic Cooperation and Development (OECD) in its 2016 LVdM report “Strengthening Corporate Governance Codes in Latin America” (OECD 2016). However, as I noted in Chapter 3, LVdM provides a negative view of corporate governance and of the main regulator in Peru as compared with those of its partner countries in the Pacific Alliance. The study is based on the opinions of the main capital market participants<sup>190</sup> (investors, banks, regulators, experts, and board members) both locally and abroad. Each year, LVdM combines surveys and interviews, with close analysis and ranking of the governance practice of over 50 corporations. The study uses EY’s own proprietary methodology described as the 5 pillars of governance<sup>191</sup> which EY claims reflect the interests of investors (Respondent 8), though the pillars used by LVdM differ from those of the 2014 governance code itself. The results of the survey, in particular the corporate rankings are published by *Semana Económica*<sup>192</sup> a major online business portal in Peru.

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<sup>190</sup> La Voz del Mercado is an international survey and in 2016 in Peru canvassed 348 market participants, received 705 written comments, and explored 56 corporations in depth (EY & BVL 2016: 104).

<sup>191</sup> The alternative EY pillars are business strategy, control environment, access to information, equal treatment of shareholders and sustainable management (EY & BVL 2016: 61).

<sup>192</sup> <https://semanaeconomica.com>

## 7.2.6 Peruvian trade associations focus on anti-corruption

The traditional trade and business associations in Peru are not noted for their engagement in the promotion of compliance with the governance code. Fourteen institutions<sup>193</sup> were involved either in the original framing of the 2002 principals or in the 2014 code and its implementation in the years leading to its launch. However, of the fourteen, only one institution was a business association – this was CONFIEP the apex business association in Peru. All of the rest were either regulators or quasi regulators (SBS, SMV and IPAI), participants in the financial markets (BVL, CAVALI, PROCAPITALES, ASBANC, AAFP, and CEMCF) or government agencies (MEF and FONAFE), or a consultancy firm MC&F. CONFIEP has apparently not been influential in promoting the 2014 governance code per se in the period 2014 to 2020, and was not mentioned by any respondent as playing an ongoing role with the code. CONFIEP is however active on broader aspects of corporate governance ([Respondent 26/19](#)). For example, in 2012, CONFIEP and PROCAPITALES collaborated to establish the *Instituto Peruano de Gobierno Corporativo*, aiming to promote good corporate governance through educational and other initiatives and to offer courses on governance in partnership with ESAN, the leading graduate business school in Peru (and ranked number five in Latin America) ([La Gestión 2012](#)). In addition, CONFIEP collaborates with its 22 member associations and with local chambers of commerce to combat corruption throughout the business sector in Peru. Citing in 2018 the effect of Odebrecht on Peru, the then President of CONFIEP Eduardo Herrera referred to corruption as the most pressing current concern, above inflation, terrorism, poverty, and unemployment noting that it is

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<sup>193</sup> SMV: La Superintendencia del Mercado de Valores; PROCAPITALES: La Asociación de Empresas Promotoras del Mercado de Capitales; Centro de Estudios de mercados de Capitales y Financiero; MEF: El Ministerio de Economía y Finanzas; SBS: La Superintendencia de Banca, Seguros y Administradoras Privadas de Pensiones; FONAFE: El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado; BVL: La Bolsa de Valores de Lima; CAVALI S.A.: La Institución de Compensación y Liquidación de Valores; ASBANC: La Asociación de Bancos del Peru; El Comité de Fondos Mutuos de ASBANC; CONFIEP: La Confederación Nacional de Instituciones Empresariales Privadas; AAFP: La Asociación de Administradores Privadas de Fondos de Pensiones; IPAI: El Instituto Peruano de Auditores Independientes; MC&F: Mercados de Capitales, Inversiones y Finanzas Consultores S.A. ([OECD 2016 \(c\): 58](#)).

prevalent throughout society, not just in big business and government (CONFIEP 2018). The following year, the new President María Isabel León expressed support for the ongoing judicial proceedings associated with Lava Jato (CONFIEP 2019).

The apparent absence of business or trade bodies apart from the apex association can perhaps be explained by recent research into the role of trade associations' engagement with tax policy following the widespread adoption of more market-oriented policies in the region. Pre-Washington consensus, many countries in the region had industrial policies as part of the widespread strategy of import substitution. Under this regime, sector-based bodies had a clear role as intermediaries in negotiations with government, at least with respect to tax policy. Post-liberalisation, business groups became the predominant model for representing business interests by influencing government directly occluding that of trade associations (Castañeda 2017: 13 - 16). It is reasonable to speculate that trade associations might well have had less interest in corporate governance than in tax policy pre-liberalisation, and that they would have even less interest in it as their role overall declined in favour of the emerging power of diversified business groups.

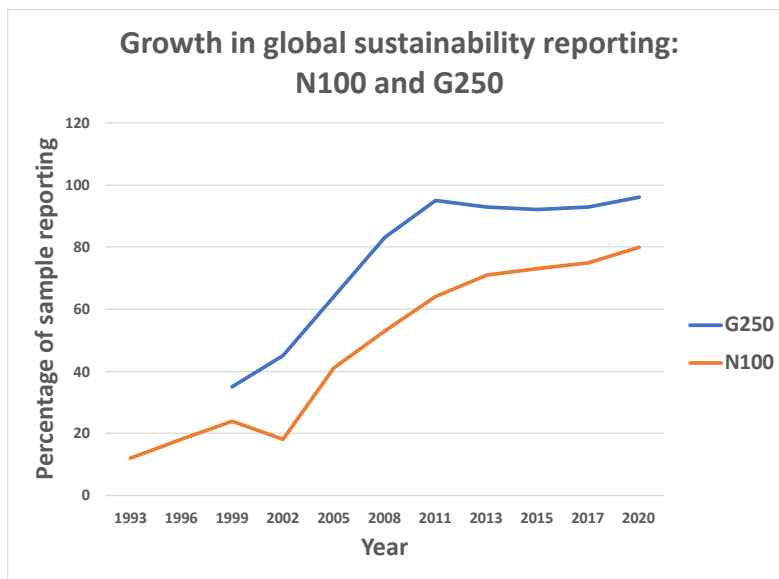
### **7.3 Peru's response to the global sustainability movement**

#### **7.3.1 Sustainability and the Global Reporting Initiative**

In Chapter 2, I referred to the literature on the CSR, ESG, Responsible Investment, and Sustainability movements which complement corporate governance, soft law codes of best practice and hard law regimes to influence the behaviours of corporations. I concluded that what had started out as separate movements with different interests and agents have now broadly converged into a single framework, which is subject to single treatment by corporations. This is now largely encapsulated in the UN's 17 Sustainability Development Goals (SDGs).

One indication of the pervasive nature of this collective movement - the one that is most relevant to the topic of corporate governance - is the growth in reporting by corporations on their status on sustainability, as I show in Figure 7.3. This has now become a mainstream movement in corporate reporting under the Global Reporting Initiative (GRI) founded by the UN in 1997.<sup>194</sup>

**Figure 7.3: Corporate sustainability reporting has grown rapidly**



Source: [KPMG 2020:10](#)

The chart shows data from KPMG, which since 1993, has been tracking corporate reporting on CSR and sustainability reporting amongst two groups of companies: the N100, a global sample of 5,200 corporations; and the G250, the world’s 250 largest companies by revenues, as defined by the Fortune 500 ranking. Both groups show a marked increase in the penetration of sustainability reporting since the outset of the exercise. The chart shows rapid growth from inception to 2011/13 amongst both samples and steady growth thereafter in the N100 reporting rate. Between 1993 and 2020 the N100 rate grew by a compound 7.3% per annum ([KPMG 2020](#)).

<sup>194</sup> The GRI is the market leader in promoting frameworks for sustainability reporting, but there are other frameworks provided by stock exchanges and others including the Sustainability Accounting Standards Board (SASB) and the International Standards Organisation (ISO) ([KPMG 2020: 24](#)).



Not only are the bulk of leading corporations now reporting on their sustainability performance under the GRI but many of them are using what KPMG refer to as Integrated Reporting where the sustainability report is integrated with the annual financial statements: in 2020, Integrated Reporting was undertaken by 76% of the G250 and by 61% of the N100. Integrated Reporting is driven in part by regulators, stock exchanges and institutional investors. Furthermore, perhaps in recognition of the interest shown by investors, a significant proportion of corporations validate the quality of their sustainability information: 71% of G250 and 51% of N100 use third-party assurance of their sustainability reports (KPMG 2020: 17, 23).

The focus of the CSR/ESG movement has progressed from simple exhortation to corporates to improve their behaviours in the social and environmental arena and from the early perception of it as an additional cost, through exploration of its role in creating value and providing a framework for reporting processes, to its attachment to the global effort by international agencies to create a sustainable future, with real traction on the attention of corporate leaders. The issues raised by the CSR and ESG initiatives are now central components in the considerations of many investors and consumers when deciding whether to invest in, trade with or work for a corporation.

### **7.3.2 Peru's response to the global sustainability initiative**

Peru has a long but mixed track record in the practice of CSR which derives in part from the important role that the mining sector plays in the Peruvian economy and the impact that this sector has on both the natural environment and on the local communities directly affected by mining operations. Despite engagement with CSR, the mining sector has generated many conflicts over environmental and social issues, and CSR claims by multinational firms were often not implemented (Loza Adauí 2010: 299).

Prior to 2008 Peru did not even have a ministry devoted to environmental issues. However, in that year it established the *Ministerio del Ambiente* (MINAM) in that year as a branch of the Executive to respond to high levels of water pollution, poor solid waste disposal, high urban air pollution, loss of agricultural land to erosion and salination and forest destruction with associated loss of fauna flora and Indigenous cultures (Loza Aduai 2010: 298).

Several respondents (Respondents 2/19, 28, 37) mentioned Peru's hosting of the COP20 meeting in 2014 as an important catalyst for an intensification of the country's approach to sustainability. It led to the crystallization of the need for corporation-level sustainability reporting, for the adoption by many Peruvian corporations of the UN Sustainability Development Goals and for the development of at least three new or reframed sustainability-oriented agencies in Peru.

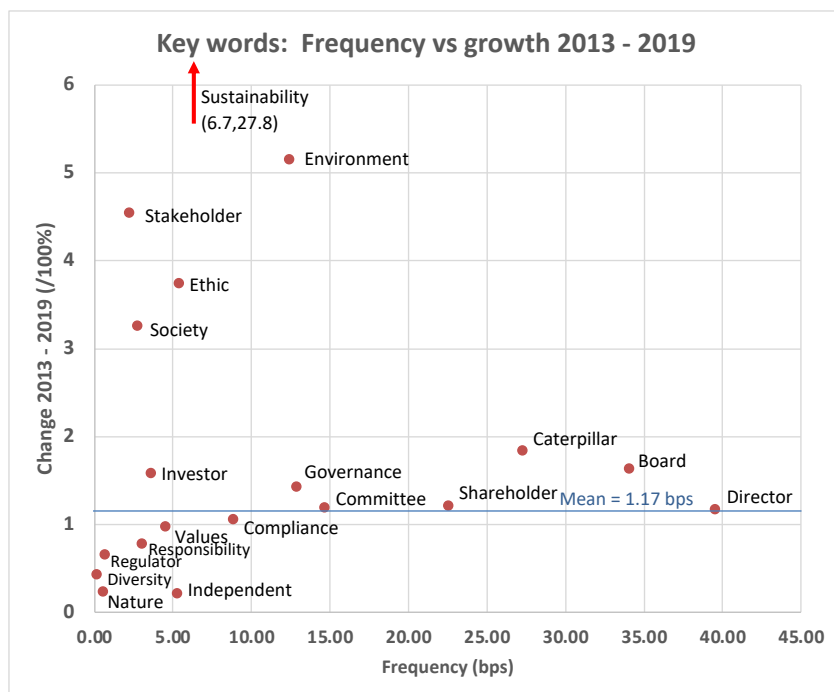
In 2015, the SMV introduced a major new component to governance reporting<sup>195</sup> alongside the 2014 governance code, in response to the launch of the UN's SDGs. From 2016 corporations would be required to produce a Sustainability Report on a 'comply or explain' basis. The resolution did not refer to specific standards but did require companies to indicate what international standards they use, as some were using the GRI framework, and the intention was for companies to report on environmental, social, and governance (ESG) impacts in their annual reporting. For the first few years, the Sustainability Report was published on a stand-alone basis alongside the annual corporate governance report and financial statements. Respondents (Respondents 11, 34) questioned the role of the sustainability report because they doubted the validity of the technical content, but the general sense was that the SMV planned to continue with sustainability reporting, integrating it with the code compliance report into a single reporting process, to cover all aspects of

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<sup>195</sup> Resolución SMV 033-2015-SMV/01

corporate governance. A study of the quality of sustainability reporting among 27 corporations listed on the BVL from 2014 to 2016 showed a steady improvement in reporting quality although the use of third-party endorsement of reports dropped off after the introduction of mandatory reporting. (Loza-Adauí 2020). However, there are considerable costs associated with sustainability reporting and as critics point out in relation to CSR in general, reporting on ‘doing good’ does not guarantee improvements in ethical behaviour especially in relation to not ‘doing bad’ (Lin-Hi and Müller 2013). Nevertheless, Peru has taken reporting seriously and now exceeds the average global reporting rates for N100 corporations. with 81% of Peruvian corporations using integrated reporting, slightly above the global average of 80% (KPMG 2020:15). Peruvian corporations have also evolved considerably in terms of the language they use to describe their businesses, as illustrated by a text analysis<sup>196</sup> of the reporting, in English, of Ferreycorp shown in Figure 7.4.

**Figure 7.4: Ferreycorp changed the focus of its communications 2013 to 2019.**



Source: Author’s analysis of Ferreycorp annual reports in English 2013 – 2019  
 Note: Words listed include normal variants. ‘Sustainability’ coordinates: (6.7, 27.8)

<sup>196</sup> I generated a key word list by inspection and used a basic text analysis software to count word frequencies.

The graph shows the relative frequency<sup>197</sup> of use of keywords by the corporation Ferreycorp (see §7). The graph shows relative growth in the use of the term ‘Sustainability’ (2780%),<sup>198</sup> perhaps not surprising given the introduction of the sustainability report, though its incidence in the Ferreycorp reports is widely distributed. Growth in the use of other terms such as ‘Stakeholder’ (460%), ‘Environment’ (520%), ‘Ethic’ (380%), and ‘Society’ (330%) reflects the transformed mores of corporate leadership along with the relative decline in other words, such as ‘Nature’, ‘Independent’, ‘Diversity’, and ‘Regulator’. Another notable trend is that during this time the sheer volume of corporate reporting has grown rapidly; the number of words used in Ferreycorp’s annual returns increased by a factor of three from 83,307 in 2013 to 251,907 in 2019.

Beyond stimulating mandatory sustainability reporting by corporations, COP20 stimulated the development of new agencies lobbying for improved sustainability. Peru embraced the frameworks offered by the UN’s *Sustainable Development Goals* (SDGs), also known as the Global Goals. These were first conceived in Rio de Janeiro in 2012 and adopted by the United Nations in 2015 as a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity. The 17 SDGs are integrated to recognise the interconnectedness of actions, and to acknowledge that development must balance social, economic, and environmental sustainability. Several corporations in Peru include the SDGs directly in their annual reports and use the framework to structure their own goals and achievements. I include examples of this behaviour in the case studies in Chapter 7. In addition, there have been developments in the agencies promoting sustainability in Peru. *PeruSostenible*<sup>199</sup> evolved from an earlier form established in 2002 – *Peru2021* – to

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<sup>197</sup> Measured as percentage share of total words used in basis points (bps) or one hundredth of a percent.

<sup>198</sup> Note that the relative frequency of the use of the word ‘Sustainability’ was so great that it would distort the graph because it increased by a factor of 28 over the period.

<sup>199</sup> <https://perusostenible.org/>

create a sustainable economy in the country. Peru2021 gained momentum from COP20 which was held in Lima in 2014 and presided over by Manuel Pulgar-Vidal the then Minister of the Environment of Peru. Peru2021 adopted and actively promoted the UN's sustainability framework in 2014 as expressed through their 17 sustainable development goals (SDGs). The agency uses the UN SDGs to promote sustainability in businesses and worked with the SMV and the BVL on designing the sustainability reporting introduced in 2016 alongside the 2014 corporate governance code ([Respondent 28](#)). *Capitalismo Consciente* was a new agency set up in 2016 as the Peruvian chapter of an organisation founded in 2013 by John Mackay, the then Co-CEO of Whole Foods Market, and Raj Sisodia, a professor of Marketing at Bentley University. Their proposition is one reflecting that of stakeholder capitalism, within which, alongside creating value for shareholders in the Friedman model, the interests of a wider group of stakeholders are considered with the promotion of wider shared values. Part of the mission of *Capitalismo Consciente* is the 'Sistema B' in which firms are recognised for their stakeholder orientation by taking on a different designation – the so-called 'B', or 'for benefit', company which occupies a space between commercial corporations and not-for-profit social enterprises ([Capitalismo Consciente 2022](#)). *Principios por la Inversión Responsable (PIR)* is another institutional import and is the Peruvian chapter of *Principles of Responsible Investment (PRI)* first established in 2005 by the UN and described as: 'the world's leading proponent of responsible investment' (UN, 2022). PIR was set up by the association of pension funds and other institutional investors, and it works to highlight the ESG investment implications of governance factors and to support investment signatories to help incorporate these factors into their investment decisions. In 2018, endorsed by the General Manager of the BVL, PIR collaborated with PUCP and, to produce an evaluation of the status of sustainability reporting by corporations. PIR studied the returns of 71, or approximately one third of the listed companies, and considered that there was still much

progress to be made ([PIR 2018: 10 - 13](#)). PIR noted that the sustainability market was still immature regarding standards: firms used a range of reporting standards on matters of sustainability, and not all used the guidelines set out in the 2015 SMV resolution. They concluded that there had been little improvement noticed between 2017 and 2018, and that: companies claimed adherence to external standards that were shown to be false; companies emphasised action in areas where there was no developed policy; action was more likely to be taken on social issues because these were more regulated rather than on environmental issues where the regulations were lighter; and only two fifths of firms made their Sustainability Reports available to the public. PIR's recommendations were not very stretching: to deepen the information provided, adopt integrated reporting, and to make sustainability reports public.

However, the emergence of coordinated institutional effort (between PIR, PUCP and the BVL) to evaluate and feedback on sustainability reporting and to encourage more consistency is an important contribution to a wider process of consensus-building around corporations' behaviours. PIR also works closely with the AAFP and the AFPs amongst others on framing responsible investment strategies and it has drawn on the S&P/Dow Jones methodology (set out below) for appraising the criteria and standards that should be applied to corporations in respect of their approach towards sustainability ([PIR 2022](#), [PRI 2022](#)).

Finally, in addition to these domestic institutions, two international ratings agencies were becoming more active in providing external metrics on corporate performance in Peru. Established in 1999, the Dow Jones Sustainability™ World Index comprises global sustainability leaders as identified by S&P Global through the Corporate Sustainability Assessment (CSA). It represents the top 10% of the largest 2,500 companies in the S&P Global BMI based on long-term economic, environmental, and social criteria. In November 2021, the S&P/BVL Peru General ESG Index was launched to measure the performance of

those securities in the S&P/BVL Peru General Index that meet sustainability criteria, applying exclusions based on non-compliance with UNGC principles, ESG business activities, or involvement in ESG controversies. In a similar vein, the S&P/BVL Peru General ESG Index is the first index of its kind in the Peruvian market, measuring the performance of Peruvian companies from the headline S&P/BVL Peru General Index that meet high standards of sustainability criteria. The Peruvian stock exchange (BVL) recognises and rewards companies that qualify for the S&P/BVL Peru General Index by granting them a discount on service fees from both BVL and Cavali as an incentive to improve their S&P DJ ESG Scores.

The second ratings agency of relevance here is Merco, launched in 2000 and described as a corporate reputation business monitor<sup>200</sup>. They provide a reputational evaluation instrument, based on a multistakeholder methodology. This methodology comprises six evaluations and more than 20 information sources. Merco produces a ranking by reputation of the top Peruvian firms covering up to a dozen firms for each of 20 industry sectors including but not restricted to listed firms and a ranking and previous year position of the reputations of 100 *named individual leaders* (Merco 2022). It claims to be the first audited monitor in the world, since the monitoring and verification of its production process and results are subject to an independent review by KPMG, according to the ISAE 3000 standard, which publishes its opinion for each edition. All the weighting criteria are public, and they can be consulted on the Merco website. Two of the case study corporations refer to their Merco ratings in their annual reports.

One important component of the Sustainability movement is diversity, whether based on ethnicity or gender, which has been reflected in a very gradual increase in the number of women in senior roles in corporations, financial institutions, and in the agencies mentioned throughout this chapter. Amongst BVL listed corporates, a study conducted by Centrum

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<sup>200</sup> <https://www.merco.info/pe/>

PUCP in collaboration with PwC and WomenCEOPeru ([CENTRUM 2018](#)) showed that the proportion of women participating in boards steadily increased from 7.7% of all *directors*<sup>201</sup> in 2012 to 10% in 2018 with a slightly smaller increase in the proportion of directorships occupied by women due to of a small number of women holding multiple roles ([CENTRUM 2018: 19](#)). The proportion of women in the most senior roles is lower and not growing: the CEO roles filled by women sat at 3.1% or just 5 individuals, and there were 11 women (4.7%) serving as general manager. The proportion of directorships occupied by women is especially pronounced in those sectors which also have high levels of code compliance: for example, AFPs – 18.8%; Banking & Finance – 11.1%; and industrials 9.8%; though also in mining – 9%. ([CENTRUM 2018: 23](#)). Although the overall level of female directors is low by European levels, it puts Peru - after Colombia with 14% - amongst the leaders in the rest of Latin America<sup>202</sup>.

The growth in the number of women on boards in Peru is due both to the increased penetration into corporates of new female directorships as well as corporations already with female directors bringing in more women. In 2012, 59 companies had at least one female director and by 2018 there were 97, an increase of 38 corporations, though most of this growth occurred between 2012 and 2016 ([CENTRUM 2018:16](#)). It might also be expected that the introduction of the new role of INED would be an opportunity for women to assume board roles, because it may be easier to bring in a female INED that it may be to promote from within if there are few women at, or approaching, the executive level. However, this is only partially the case. In 2018, of the 142 director *roles* occupied by women, 43 were independents, and the number of full director roles had increased from 60 in 2012 to 99 in 2018 while the independents had increased from 34 in 2012 to 43 in 2018. Most of the

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<sup>201</sup> Women directors: 72 in 2012 to 113 in 2018; Directorships: 94 in 2012 to 142 in 2018.

<sup>202</sup> See Heller and Gabaldon ([2018](#)) for a regional quantitative analysis of women on boards in Latin America.



growth therefore occurred through full directorships. I suspect that some of these new roles will include special responsibilities for legal, sustainability, ethics, and compliance.

Anecdotal evidence from the interviews conducted for this project suggests that women occupy more than half of the managerial roles below director level in compliance, legal, ethics, staff communications and sustainability reporting. Further growth in the proportion of women in senior roles should not be held back on structural grounds such as participation levels in the workforce or differences between the sexes in university education. At the most basic level, female participation in the workforce in Peru is one of the highest in the region at 69-70% in the period 2014 to 2019, though it had peaked in 2008 at 72.5%<sup>203</sup>. For directorships, however, university education is an important precursor to board service and over two thirds of current serving female directors are graduates<sup>204</sup> (CENTRUM 2018: 33).

Although as noted in Chapter 3 Peru is a very divided society on many dimensions, not least gender, amongst elite groups, female graduation from two top universities, one public (UNMSM) and one private (PUCP) – is at 48%, almost on a par with that of males (52%) (CENTRUM 2018: 21). One agency in particular has been in the vanguard of promoting women in public life. *WomenCEOPeru*<sup>205</sup> is a recently formed and very prominent agency for the promotion of women in senior roles. The organisation is an international agency based in Mexico, Spain and Peru and has the objective of 30% female board representation by 2030. It has close links with PUCP which has a dedicated centre in its business school (Centro de la Mujer de CENTRUM PUCP) to provide training for board roles, alongside events to promote female participation. PUCP. *WomenCEOPeru* is also closely associated with sustainability and the UN Global Compact and UN SDGs and with the diversity movement.

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<sup>203</sup> [https://www.theglobaleconomy.com/Peru/Female\\_labor\\_force\\_participation/](https://www.theglobaleconomy.com/Peru/Female_labor_force_participation/)

<sup>204</sup> With the top six specialisms being Law (24.8%), Architecture (22.7%), Geological Engineering (19.7%), Business Administration (15.2%), Advertising (14.4%), and Civil Engineering (14%) (CENTRUM 2018: 37).

<sup>205</sup> <https://womenceoperu.org>

Beyond corporations, women feature prominently in agencies such as PwC and EY, BVL, MEF, CENTRUM PUCP, *PeruSostenible*, *Capitalism Consciente* and *Empresarios por la Integridad*, some of whom were interviewed for this study.

It is important to note that the mere existence of these new institutions does not guarantee ethical behaviour, in fact some critics suggest the opposite. I introduced the term ‘greenwashing’ in Chapter 2 and noted that an important component of the Power Hypothesis was the intention on the part of the corporation to deceive. The claim of greenwashing is still very pertinent for critics of the sustainability movement. To illustrate, a sustainability strategist has recently suggested that the B Corp Certification standards and registration processes may be encouraging a form of greenwashing, insofar as subsequent registrations may be offered to the firm without any material improvement on its part. This means, then, that there is no incentive for firms to continue to improve; indeed, once they have the endorsement they seek, they may actually relax their standards (Rae-Taylor 2022).

Nevertheless, there has been a significant development in new institutions which both support the traditional view of good corporate governance and go further by repositioning corporate governance as part of a much wider movement and one that has more saliency for non-technical people. These latter include the very employees of the corporations concerned; a point which I developed in Chapter 6. These agencies provide endorsement to corporations for having appropriate standards and behaviours and are sought after by corporations that publicise such endorsements in their annual statements. In parallel with these developments in the sustainability movement, in 2017 Peruvian society was shocked by the revelations of an investigation into a procurement corruption scandal that had originated in Brazil, but which became centred on Peru and brought good - or rather bad - corporate governance into the public arena.

## 7.4 Peru's response to the Odebrecht scandal

In 2021 the Lava Jato investigation team formally disbanded after seven years of investigation. During that time, it was responsible for 295 arrests, 278 convictions and 4.3 billion reals (\$803 million) of fraudulently obtained funds being returned to the Brazilian state, in what was described by the US Department of Justice as *'the largest-ever global foreign bribery resolution'* (Simon 2019).

### 7.4.1 Peru as the axis of corruption outside Brazil

Odebrecht was the largest construction company in the region and had begun to internationalise its operations beyond Brazil in the 1970s. Odebrecht's operations in Peru started slowly from 1979<sup>206</sup> but grew rapidly in the 1990s driven by a partnership with Graña y Montero, Peru's largest construction company. Graña y Montero granted Odebrecht access via family connections to the upper strata of Peruvian society and political leadership. During the 1990s Odebrecht developed a relationship with Alan Garcia who extended his patronage to multiple executives in the firm to pursue his own projects. According to Durand Odebrecht sought to understand the bureaucratic mentality of decision-making in Peru, and,

*'...wove together all types of relationships including politicians, congressmen, business associations, journalists, experts, ONGs and foundations and always with the support of the Brazilian Embassy in Lima. They understood the local custom of waiting or asking for a "commission" to authorize works, accelerate a project, avoid control procedures and approval processes for budget increases.'* (Durand 2018:108)

Between 2005 and 2014, El Comercio estimate that \$29m was received by government officials (Parra 2016). In a history of corruption in Peru Quiroz noted that, *'...in*

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<sup>206</sup> Two projects: the first, hydroelectric project Charcani V in Arequipa, won in part because of the backing of Banco de Brazil, and the second, the 1988 with the Chavimochic coastal irrigation project, was carried out in two stages in La Libertad.

*Peru corruption was not something sporadic but rather was a systematic component rooted in structures central to society*' (Quiroz 2008: 34). However, Odebrecht appears to have taken a cottage industry and industrialized the process by integrating it into its business model<sup>207</sup> (Smith, Valle and Schmidt 2017, Campos, Engel, Fischer and Galetovic 2021:172-174). Studies comparing projects with and without bribes show that average cost increases were 5.6% with no bribes and 70.8% with bribes (Campos et al. 2021:178).

Essential to this process of industrializing corruption in Peru was the systematic influence over local and regional government processes<sup>208</sup> and over a succession of Presidents.<sup>209</sup> Durand notes that Peru had no master plan for infrastructure development and benefitted from growing commodities markets and so was very vulnerable to the incursions of its larger neighbour. Not only had Peru become the major territory for Odebrecht outside Brazil, but the group's Lima head office became the locus for managing its investments in other countries '*from Mexico to Santiago de Chile*' (Durand 2018:116). By 2010, Odebrecht had 20 subsidiary companies operating in Peru and between 2001 and 2016 it had completed dozens of infrastructure projects, to the value in the region of around 50bn Sol (c. US\$15bn)

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<sup>207</sup> This went beyond establishing a department to manage bribes. Odebrecht had a range of available strategies including manipulating the contract guide price; exaggerating technical capabilities; and biasing technical scoring processes. Perhaps the most effective approach was the *quid pro quo* arrangement to secure the promise of a future renegotiation, so as to increase a project's cost despite laws to prevent such an occurrence. Odebrecht achieved these project extensions by capturing parts of Peru's legal framework for regulating construction projects, in order to influence both the procurement process and the re-specification of parts of the project to enlarge them beyond the initial scope (Campos et al. 2021).

<sup>208</sup> Analysis by Convoca shows that 32 parliamentarians from different political parties presented 41 bills during the period 2001 to 2016 with the aim of facilitating and promoting infrastructure works that would end up in the hands of the Odebrecht construction company and other Brazilian companies. Of the 41 projects, 25 were approved with the vote of most of the members of the commission and became law (Gutiérrez, Rodríguez, Quispe, García, Patiño and Valentín 2018).

<sup>209</sup> Odebrecht experienced an upsurge in the flow of projects following the election of President Fujimori who oversaw 30 infrastructure projects with Odebrecht and during his tenure (1990 – 2000) was recognised internationally as presiding over the most corrupt of governments, Odebrecht continued under the three subsequent administrations; Toledo (2001 – 2006), Garcia (2006 – 2010), and Humala (2011 – 2016) (Durand 2018: 109 – 115).

(Gutiérrez, Rodríguez, Quispe, García, Patiño and Valentín 2018). Peru had become Odebrecht's main vehicle for extending its reach throughout the continent.<sup>210</sup>

The so-called Lava Jato investigation began in March 2014 as a minor investigation into money laundering but expanded into a corruption investigation into the state oil company, Petrobras, where executives were accepting bribes for awarding construction projects. As the Petrobras investigation continued, Odebrecht's involvement in wider corruption was discovered. In Brazil, Odebrecht had massive fines imposed, CEO Marcel Odebrecht was imprisoned for 15 years, and many executives and public and political figures lost their positions.

#### **7.4.2 Consequences for institutions and societal attitudes in Peru**

The effect on Peru as Odebrecht's main staging point outside Brazil was profound and from 2017 involved a stream of tangible developments as well as a new sense of entitlement to speak out on matters of corruption. Peru, along with Brazil and Colombia, adopted a strongly judicialized approach, with national courts undertaking investigations into which national politicians and parties had accepted bribes and what Odebrecht had received in response (Hochstetler 2017). The tangible results of this approach included: the prosecution of four ex-presidents - one of which is still in process – leading to imprisonments and one suicide; prosecutions of several corporate executives and scores of public officials; the near bankruptcy and complete change of board and senior management of Odebrecht's principal agent and partner in Peru, *Graña y Montero*, which once had amongst the highest levels of compliance with the corporate code, and which changed its name to *Aenza* in 2020 (see later case study in appendix); and collateral damage amongst other corporations in the form of

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<sup>210</sup> Other leading Brazilian construction firms were also involved; between 2003 and 2012 Peru spent \$8.2tr on infrastructure projects from the top 20 Brazilian construction groups, double that of any other country in the region (Da Rocha 2013: 167).

discovery of other scandals, such as political bribery<sup>211</sup> and the so-called Construction Club<sup>212</sup> of which Graña y Montero was a member and which led to several corporations changing their boards and senior management (see small-N case studies of COSAPI and Credicorp in appendix and §6.3)

On the positive side the Odebrecht episode led to the creation of new anti-corruption agencies in Peru, all with the brief to combat corruption - though using widely very differing tactics - along with the widespread adoption of a new ISO standard aimed at anti-bribery.

The first agency, *Consejo Privado Anticorrupción (CPA)*, is a local private sector initiative that was established in 2016 during the Odebrecht disclosures. The CPA seeks to influence the generation of incentives positively and constructively with defined lines of action; namely, the promotion of ethical values, and the simplification and (it is hoped) better implementation of regulation. The CPA has the support of 24 business associations including CONFIEP, the apex business association and the BVL. The CPA's most prominent campaign is *Vigilancia Activa*, a project to draw attention to public sector nepotism, incompetence, false credentials, and illegal behaviours through announcements of new appointments placed both on its website and via WhatsApp daily to subscribers ([Respondent 18/19, CPA 2022](#)).

The second, *Empresarios por la Integridad (EplI)*, was established in 2017 after discussions at the *Conferencia Anual de Ejecutivos (CADE)*<sup>213</sup> in 2017 which was organized by the *Instituto Peruano de Administración de Empresas (IPAE)*<sup>214</sup>. IPAE funded the

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<sup>211</sup> In 2019, Credicorp's then Chairman Dionisio Romero testified before the prosecutor that he had contributed \$3.65m of company money to fund the 2011 presidential campaign of Keiko Fujimori between November 2010 and May 2011 in 17 cash tranches ([www.peruviantimes.com](http://www.peruviantimes.com))

<sup>212</sup> The '*Club de la Construcción*' was a cartel of over 30 construction companies including Odebrecht, Graña y Montero, Cosapi, ICCGSA, Málaga, OAS and Andrade Gutierrez and Camargo Correa which operated 112 projects between 2002 and 2016 by coordinating tenders and eventually fined 2.76 bn Sol (c. US\$690) by INDECOPI the state competition and consumer protection agency ([www.perusupportgroup.org.uk](http://www.perusupportgroup.org.uk))

<sup>213</sup> CADE: The Annual Conference of Executives, one of IPAE's initiatives to bring together the main leaders of the private, public, academic and civil society sectors.

<sup>214</sup> IPAE: The Peruvian Institute of Business Administration was formally established in April 1959 to disseminate and promote the scientific management of Peruvian companies in order to contribute to improving their performance, working with other agencies such as *ESAN*, *Bolsa de Valores de Lima*, *SENATI*, *CONFIEP*, *Consejo Nacional de la Competitividad*, *Observatorio de Educación y Empleo*.

development in partnership with the long-standing ex-CEO of Credicorp. The agency is an advocate of anti-corruption and works directly with firms to endorse their commitments to anti-corruption through a process of certification for which EpII receives fees. EpII is essentially an initiative driven by a community of senior business executives who are, *‘committed to building a better Peru, aware of the major problems facing the country, including corruption, and convinced that because of their role, they have a great responsibility for finding a solution’* (EPII 2022).

Interviews revealed that that CPA and EpII do not appear to be collaborating, despite their related missions (Respondent 28, 29).

Initiatives were also undertaken to stem corruption in the public sector through the *Offices of Institutional Integrity*. In a 2017 ‘Integrity Review’ of Peruvian public institutions, the OECD pointed out that public policies and conflict of interest policies in Peru were fragmented with little clear relationship between them (OECD 2017) Their conclusions led into two initiatives: the National Policy of Integrity and Fight Against Corruption (PNILC, Supreme Decree 092- 2017-PCM) and the National Plan of Integrity and Fight Against Corruption (Supreme Decree 044-2018-PCM). Together, these initiatives formed the basis for the creation of the Offices of Institutional Integrity (OII) within each public organisation with the objective of rooting out corruption. Rather than relying on individual OIIs, one of the mechanisms proposed was the so-called three lines of defence involving Management, Oversight, and Independent Audit as distinct layers of intervention to control corruption (OECD 2019). According to the OECD, these processes are now common in other countries.<sup>215</sup> Whether the OII system penetrates to the regional and local government level remains an open question.

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<sup>215</sup> In 2018, the OECD cited Uruguay, Peru, Paraguay, Mexico, Honduras, and Brazil (OECD 2019: 22)

Peru also responded positively to the creation of a new international judgement validator in the form of the *ISO37001* standard, designed to combat bribery. The International Organization for Standardization (ISO) was founded in 1947 and produces internationally recognised standards to facilitate trade. In 2016, ISO 37001 established an international anti-bribery management system designed to help any organisation implement and maintain a proactive anti-bribery system, although it did not address fraud, cartels and other anti-trust/competition offences, or money-laundering, which might act as supportive institutions to bribery. In 2017, the Peruvian Government issued a translation of ISO37001 as a voluntary standard for anti-bribery, in line with a Legislative Decree no. 1352, and issued as a ‘preventative model’ for later enactment ([Abad 2017](#)).

There has been significant take-up of ISO37001 among Peruvian corporations driven by a need by companies to distance themselves from corruption ([Respondents 14/19, 35](#)). As an anti-corruption lawyer working with ISO commented:

*‘In 2000 there were no bribery cases, but now you have these huge cases like Operation Carwash in Brazil. This is a complete revolution. It’s not only in Brazil, but also in Peru and Argentina and across South America. I think it is no longer possible for companies to do business as before and there has been a change of climate. In the last few years, we can see that corruption has become the focus in many countries’* ([Mean 2020](#)).

Odebrecht also left a legacy of new laws and adjustments to existing laws covering the criminality of corporations, payment of compensation to injured parties, criminalizing bribery, facilitating whistle blower channels in corporations, new mechanisms to protect whistle-blowers, and new mechanisms to punish public sector workers for abusing their office. Perhaps the most significant was the enactment, in January 2018, of Law 30424 to establish *criminality for corporations*. Originally approved in 2016, this law was had been



amended in 2017 to cover bribery, money laundering and financing of terrorism with the intended effect to place with the board the responsibility for rogue individuals (Tovar and Chávez 2021). In April 2018 the Peruvian government enacted Law 30737 (which replaces Decree 003), called the "anti-Odebrecht law", to ensure immediate payment to the State of civil compensation for corruption offences and to facilitate the resumption of investment projects in the country (AgenciaEFE: 2018). Focus was also placed on public officials in January 2019 when the Peruvian Penal Code was modified to make *bribery a criminal offence* with jail terms of four to 12 years. Other changes were also made - in January 2019 the president announced that companies and *civil servants found guilty of corruption, bribery and exertion of influence* can't ever work for the Peruvian state again - not for the central government, nor for regional governments or municipalities - and that all public contracts will contain a special *anti-corruption clause* in the future. Whistle blowers were also provided with additional support and protection through the introduction of new law<sup>216</sup> (El Peruano 2017).

Two issues remain with this new legislation. First, the mere fact that a law is on the statute does not mean that it will be effective; discovery of misdemeanour is an essential precursor to successful prosecution. Second, and related, an evaluation in 2018 of an initiative established by Alan García in 2010, the *Comisión de Alto Nivel Anticorrupción* indicates that there is still a rift between the layers of administration in Peru i.e., between federal, regional, and local government and much of Odebrecht's activities involved regional and local government over which Federal anti-corruption initiatives have little effect (CPI 2018). One underlying factor which created the opportunity for Odebrecht was the chronic underspending of authorised infrastructure budgets. At the national level, between 2016 and 2021, Peru has underspent federal infrastructure budgets by an average of 38.3%, yet

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<sup>216</sup> Law 30506 and legislative decree 1327

underspending was much worse at regional and local government levels with underspends of 41.2% and 53.8% respectively (Comex 2022: 8). This continued underspending shows no signs of abating, so the temptation for further corruption remains, if only to mobilize these resources on a *'Roba pero hace obra'* basis.

## 7.5 Conclusions

Peru had a less-than-promising institutional ecosystem when the code was launched in 2014 with few of the supportive institutions discussed in Chapter 2 as being necessary to support the UKCC. Schrank (2020) coined the term institutional *underpinnings*, to highlight the essential role played by such an eco-system in supporting the successful importation of a voluntary comply-or-explain corporate governance code. During the period 2014 to 2020, I have identified several important developments which go a long way to providing such *underpinnings* albeit not identical to the UK institutions. These developments represent a largely home-grown response first to weaknesses in key institutions in Peru, second to the global sustainability movement, and third, crucially, to the shock of the Lavo Jato scandal in which Peruvian corporations and public officials had played such a key role for over a decade. Unlike the code, which was largely imported after some minor adaptations, these developments have rather more *'emerged from the preferences and choices of the actors concerned'* (Weyland 2009: 14) and so should have some traction. Therefore, even where the origins of a new institution have been international, such as is the case with the anti-bribery standard ISO37001, individual corporations are exercising their own judgement in adopting such standards. The new institutions are thus likely to persist and to continue, at the very least, to support the progress that has been made on code compliance, but also to continue to encourage certain firms to keep improving their governance. More importantly, these developments are not just isolated initiatives but, when seen in the light of the multi-level model for legitimacy seeking proposed by Bitektine and Haack (2015) in Chapter 2, the

individual initiatives can be seen to be playing a role in a broader process. This process is one in which Peruvian corporations are submitting themselves to an evaluation of their suitability as business partners by one group of actors in a process of collective judgement formation which is supported by another group of actors who, in turn, provide a range of validations of the corporations' behaviours.

'Evaluators' are engaged in ongoing commercial relationships with corporations and must evaluate the suitability of the corporate as a worthy recipient of the license, product or service that is on offer or, at least, must be able to price the said service according to the actors' perception of associated risk. The strengthened evaluators would include the AFPs, the BVL, and the SMV, along with local communities, business partners and clients engaged in the sustainability, ESG, and diversity debate. In the next chapter, I will provide evidence for additional important evaluators including the international financial markets and corporate employees and partners now increasingly engaged in governance in some firms. The interchange between evaluators and corporations is mediated via an interchange of finance, revenues and fees, services, conferred reputation, license to operate and ability to operate. Evaluators are in fact individual and/or teams of analysts who must form judgments about their organization's mode of engagement with the corporation. "Validators" provide endorsement for the quality of specific aspects of corporations' behaviours, processes, and standards. The new, newly introduced, or rejuvenated validators will include ISO, Merco, S&P/DJ, the UN via its SDGs, *Consejo Privado Anticorrupción*, *Empresarios por la Integridad*, *WomenCEOPeru*, *Capitalismo Consciente*, and *PeruSostenible*, as discussed above. They perform this validation role by using several specific mechanisms based on relationships, often an interchange of fees, evaluations of activities against clearly defined custom metrics leading to endorsements in the form of prizes, awards, and certifications. They also provide frameworks for perceiving of different dimensions of corporate behaviour

and a language that can be shared by interested parties. I will provide further evidence in support of the importance of Validators to corporations in the next chapter. Validators persist to the extent that they find a niche business model involving fees for endorsements that functions with sufficient integrity. The evaluators and judgement validators both contribute to a community that participates in the governance market in Peru and add their voice to the maintenance of the institutional facts that is the new governance behaviour through the collective intentionality referred to by Searle (1955).

In this institutional context, each corporation is unique: it pursues its own business model that determines its suppliers, partners and clients and how it decides to manage its workforce; it has its own financing model, which determines its engagement with equity and bond markets, and banks and institutional investors, both of which are groups of Evaluators; and it forms its own strategy for securing endorsements for business processes and ESG behaviours, which determines its engagement with Judgement Validators.

Testimonial evidence from corporate executive respondents will show that the Evaluators do feature in the corporations' own constellations of influencers and that although the nine agencies described above are not reported as influencing corporate decision-making directly with respect to compliance, it is apparent that several large corporations recognise the role played by these agencies as Judgement Validators. These corporations are very keen to have the endorsements that these agencies provide, whether this be receiving accreditation from EpII, acquiring ISO37001 certification, or subscribing to the UN SDGs - and proclaiming these facts on corporate websites. However, the effect is not just as validators but also as shapers of opinions; some effects can be considered somewhat more direct, for example, the PIR's and the S&S/Dow Jones' approaches to sustainability influence how the AFPs design their investment policies, and also influence how the SMV has developed the sustainability report required of corporations annually. One result of these networks of

influence is that the notion of sustainability is now a topic that has great saliency in Peru. More broadly, some respondents noted that one important legacy of the Odebrecht scandal is that Peruvian society was shocked by the scale of the corruption and felt that since this was a widely shared belief, people were more likely to speak out against corruption with the confidence that they would find support for their views.

From an institutional perspective, these developments constitute at least the makings of an institutional ecosystem providing strong endorsement to maintain and perhaps improve governance in relation to the new institutional facts created by the constitutive rules of the 2014 code. This indirect influence provides an important endorsement of corporate governance behaviour and has been taken up and accepted by corporations. Not only do these agencies through their expression of collective intentionality help to reinforce the 2014 code, but they also reframe and reposition the governance code as part of a wider sustainability movement. This transformation represents an additional layer of institutional facts grafted on to the 'old' one, and crucially, has the effect of opening governance to a wider market and new audiences with huge saliency for Peruvian society. This was never previously the case for the comparatively 'dry' topic of governance.

In Chapter 8, I will first draw together the conclusions and findings from the three research chapters and the wide range of documentary, testimonial, and analytical material to form a judgement about the prevalence of the rival decision-making processes and how they relate to compliance with the 2014 code using Bayesian Inference as an integrative framework. I will then develop an elaborated theory of decision-making for corporations to explain higher-than-average compliance with constitutive rules based on legitimacy seeking in their chosen domains.

## Chapter 8      A new theory of corporate decision-making

### 8.1      Introduction

In this chapter, I will draw together the results from Chapters 5, 6, and 7, using Bayesian Inference to inform a judgement about the rival hypotheses established in Chapter 2. I will then build on the empirical research findings to develop a more elaborate theoretical framework for corporate decision-making in relation to code compliance.

I will show that there is strong evidence to support the association of the hypothesis of Legitimacy Seeking with higher levels of compliance with the code, especially for constitutive rules that introduce third parties into governance. While I also found evidence for the rival hypotheses of Efficiency and Power, this was associated either with low levels of compliance or with some attempt to disguise true governance behaviour. I will then elaborate on the mechanisms associated with each of these hypotheses with a particular focus on legitimacy seeking - and present a revised theoretical framework to explain the decision-making processes of listed corporations in Peru. I will also integrate into this revised theory of explanatory decision-making processes the other three components of the theory developed in Chapter 2, namely that constitutive rules are the most contested; that all three rival decision-making hypotheses coexist in any given firm; and that across the population of firms, there is equifinality or multiple bundles of reasons for high compliance by corporations.

Since I will use Bayesian Inference in this integration process, I will recap briefly on the salient aspects of this approach here.<sup>217</sup> The core notion is that the concept of weight of evidence is used to calibrate judgements about the relative likelihood of highlighted evidence emerging in the alternative worlds implied by pairs of rival hypotheses, and that this weight of evidence is used to discriminate between the paired hypotheses. This is achieved in three

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<sup>217</sup> Please refer to §4.3 for a fuller account

stages: first a *Prior Weight of Evidence* is established reflecting working assumptions about the non-equivalence of the hypotheses under study; second, this is updated by adding *Weights of Evidence* derived from successive tranches of highlighted evidence<sup>218</sup> collected from different sources; third, this process yields the *Posterior Weight of Evidence* reflecting my ultimate degree of belief in each of the rival hypotheses.

I will first set out my rationale for a non-equivalent prior weight of evidence to reflect my starting judgement about the rival hypotheses delineated in Chapter 3.

## **8.2 A priori, the literature favours the Power hypothesis**

My starting point is to favour the Power hypothesis over the rival Legitimacy and Efficiency hypotheses, based on an evaluation of highlighted evidence provided by the academic literature. In Chapter 3, I provided three different perspectives on capitalism in Peru, which appear to agree on the common features of corporations in the country. These features are: the structuring of the business to hedge risks and maximise profits; the maintenance of tight control of the corporation by a small, self-interested, often family, group; the exclusion of third parties; and the manipulation of the environment in the firm's own self-interest. When confronted with a governance code containing constitutive rules, corporate leadership is likely to exercise impunity in its own self-interest, if necessary, to the point of deception. The constitutive rules in the 2014 code are therefore likely to be strongly, albeit covertly, resisted. The first perspective is provided by Monsalve's historical perspective, in which the evolution of corporations and of corporate governance describes corporations as having developed very independent approaches to strategy, structure and governance. This enabled them to survive an often volatile political and macroeconomic

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<sup>218</sup> More technically, highlighted evidence will be that which has a log-odds ratio not equal to one and so will have a non-zero Weight of Evidence in favour of one of two paired hypotheses.

environment, in which policies were frequently hostile to large corporations (Monsalve 2014). The second perspective is from the theory of Varieties of Capitalism where the prevalent variety of capitalism in Peru, the Hierarchical Market Economy, is described as dominated by a small elite group of controlling families that rely on established complementarities involving poorly organised labour and a large pool of informal workers (Schneider 2013). Finally, from an institutional evolutionary and political perspective, corporations are seen to exert political influence when it suits them, and the Peruvian state is considered by some authors of being wary of implementing policies which are likely to be against the interests of big business. This close relationship is further manifested in the revolving doors of quid pro quo recruitment, and where there is a persistent level of corrupt behaviour between the public and private sector over tender processes and the deployment and management of public funds (Wise 2003, Quiroz 2008, Dargent 2015).

A priori, these three accounts favour the Power hypotheses in which owners seek to maintain their own control over corporations while deceiving the governance market or misrepresenting or ‘gaming’ compliance in some manner. In contrast, the Efficiency hypotheses would appear to be much less likely; the idea of firms being concerned about the costs of alternative rules when their energies have been directed towards the expression of control, politicking, and robust hedging against an uncertain world seems unlikely - quite the opposite in fact. Similarly, the Legitimacy hypothesis also seems much less likely; tightly controlled firms are not a priori likely to be seeking to appease powerful outsiders, in order to be accepted and be legitimized.

On this basis, I record a ‘strong’ distinction between the Power hypothesis and the others, but do not consider that the difference should be overwhelming. This is partly because the accounts given in the literature are somewhat historic and may be less relevant now than the time periods they highlighted, and partly because it would negate the original spirit of the



investigation i.e. that the hypotheses should be rivals. Guided by the calibration scale offered by Fairfield and Charman (2022: 133) in §4.3, I attribute 20dB as my *Prior Weight of Evidence* in favour of the Power hypothesis, with the Efficiency and Legitimacy hypotheses on an equivalent rating.

I will now *update* this prior judgement by adding the weights of evidence from each of the three results chapters, to determine a *Posterior Weight of Evidence*. In each case, I will highlight just that evidence which I consider more likely to appear under one hypothesis than another in each pair of rivals, so as to discriminate between them. Although other evidence may be interesting in a general sense and, indeed, in other chapters informs my development of theory, for the purposes of discriminating between the hypotheses, it can be ignored.

I will first examine the plausibility of each evidence bundle in the world of each hypothesis and then consider the *relative* likelihoods of highlighted evidence emerging under matched pairs. This will allow me to determine the weight of the evidence in establishing a differential judgement between hypotheses.

### **8.3 Updating the prior judgement with highlighted empirical evidence**

#### **8.3.1 Analysis of corporate compliance favours legitimacy-seeking**

From Chapter 5 I have identified six topics from the analysis of compliance that would appear to be worth highlighting. These are: the wide population variance in compliance; differences in level and growth of compliance for constitutive and regulative rules; continual year on year movement in firm scores; the association of compliance with multiple external agents; the importance of situational factors; and clear equifinality.

A clear feature of the analysis of compliance - whether analysed by corporation or by rule and whether broken down by constitutive or regulative rules - is that there is a great deal of variance in compliance across the population. This variance, as I noted in §5.3, has not

reduced, despite an increase in mean compliance between 2014 and 2020. Such a feature would seem to be very implausible in a world where firms were making rational economic choices to decide between existing governance practice and the new rules. It does not seem very likely that different corporations would see the operating costs of rule implementation so very differently. By contrast, such a phenomenon will seem to be plausible if one considers the opportunity cost of rule compliance, particularly for constitutive rules. Under the Power hypothesis, firms would differ in the degree to which they experience the wider opportunity costs of no longer being able to conduct covert or corrupt practice, which would have to be given up by adopting the new constitutive rules. Wide variance between firms would also be very plausible under the Legitimacy hypothesis in a world where firms differed in their degree of exposure to agentive relationships in their market or value chain and took different decisions about the role of governance in such relationships. The year-on-year movement in firm scores involving most firms would appear to be neutral in the worlds of the Power hypothesis - it is difficult to imagine that the influence of external agents or a firm's approach to exercising its influence would vary much year on year. However, it is even more difficult to imagine why the costs of implementing or maintaining rules would change so much as to affect cost-benefit considerations and so the Efficiency hypothesis would be even more disadvantaged.

The marked population difference in compliance by type of rule - where constitutive rules have much lower compliance - would at first glance seem to be more plausible under either of the Efficiency or the Power hypotheses. In the world of the Efficiency hypothesis, it would be natural to avoid new rules that introduce more cost - for example the additional costs of INEDS. In the world of the Power hypothesis, it would seem natural for hierarchical capitalists to keep third parties out of governance. In the Legitimacy-seeking world, the low constituent rule compliance would seem not to be consistent. However, an important

counterpoint is that constitutive rule compliance increased much more rapidly than regulative compliance and it did so in two surges, for both of which there are reasonable explanations. This is much more consistent with a Legitimacy-seeking world where there are practical issues associated with implementation and clarity, or where there are external drivers for the second surge. Such effects are less plausible in the Efficiency world – why should the cost-benefit change? Likewise in the Power world – why give up power? Indeed, the overall upward trend in compliance is more consistent with a legitimacy world because, as I will show, it is in the world of legitimacy-seeking that there is a real upside to adopting expensive and intrusive governance procedures.

There is strong evidence for the importance of external agents regarding firms' high compliance as shown in Figure 5.1, while the results of the regression are shown in Figure 5.2. This is especially the case with the domestic and international financial markets. This effect is especially strong considering the cumulative effects of factors, the additional explanatory value of the interactions examined in the MLR and the INUS conditions for sufficiency causality from the csQCA. These findings are very consistent with the Legitimacy world, in which firms seeking acceptability - for example, to raise external finance - must meet certain criteria before they are allowed to issue equity or bonds or take out bank loans at reasonable rates. Firms know that their governance records are public documents and so it is reasonable to assume that they will use their compliance performance as a communication tool. Such evidence is less consistent with the world of the Power hypothesis, which would imply covert behaviour around some constitutive rules, but a response to an accumulation of factors does not seem likely, and in any case such firms are unlikely to seek outside finance for fear of creating vulnerabilities towards outsiders. The evidence is also less likely in the world of the Efficiency hypothesis: the potential costs and benefits associated with raising

corporate-scale finance would far outweigh any cost considerations of alternative governance rules and so a narrow cost-benefit analysis of the rules would seem to be irrelevant.

The analysis showed strong associations with both industry sector and with the business model employed by the corporation indicating that some aspects of the value chain and the corporate structure influence a corporation's compliance with the code. In addition, it underscores the importance of the regulator. Initially the SBS was seen to be the stronger, but the SMV went on to become more active, contributing to the second 'surge' in constitutive compliance. All these effects would seem to be consistent with the Legitimacy hypothesis whether the corporation is seeking acceptance from a member of the value chain - be they customers, partners, or suppliers - or from corporate command, or from the regulator. This evidence might seem to be somewhat plausible in the world of the Power hypothesis since each one of these entities would be engaged in a long-term relationship with the corporation, but it is difficult to see how such relationships would result in high compliance in this world. This is also the case for the Efficiency hypothesis.

All three modules of analysis underscored the existence of multiple instances of equifinality in the associations between conditions and the outcome of relatively high compliance. These instances often involved combinations of multiple factors in INUS bundles to produce different conditions of sufficiency causality. These findings are extremely plausible in the world of the Legitimacy hypothesis in which each corporation might find itself in unique circumstances, faced with an array of exogenous factors and dealing with multiple agents who might have an interest in aspects of governance. Equifinality might also appear to be plausible in the worlds of the Efficiency and the Power hypotheses but would likely be more driven by internal factors rather than with various external agents. However, in contrast to the Legitimacy hypothesis, this evidence would probably be associated with lower rather than higher compliance.

## Judgement of Weight of Evidence for pairs of hypotheses

The initial considerations of the plausibility of evidence bundles under each hypothesis set out above, are an important precursor to judging the *relative* value of the evidence bundle in the likelihood ratio of paired hypotheses.

On the first paired comparison, *Efficiency and Power*, some of the highlighted quantitative evidence - in particular the wide population variance and the extensive firm by firm movements - is somewhat more likely to emerge under the world of the Power hypothesis than that of the Efficiency hypothesis, where the evidence appears to be rather implausible. I therefore rate the Weight of Evidence to be in favour of  $H_P$  over  $H_E$ <sup>219</sup> as +3dB to reflect the just-discernible difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, the bulk of the highlighted quantitative evidence - especially the wide population variance, the rapid growth in constitutive compliance in the second surge, the strong associations with external financial market participation, and the extensive equifinality - is by far more likely to emerge under the Legitimacy hypothesis. This is because the factors that are most prominent from both analyses offer clear mechanisms aimed at legitimacy-seeking although the form of the legitimacy sought differs across the range of factors and firms under consideration. I rate the Weight of Evidence in favour of  $H_L$  over  $H_P$ <sup>220</sup> as +20dB to reflect the marked difference between the likelihoods.

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<sup>219</sup> Denoted  $\log[P(EQ|H_E)/P(EQ|H_P)]$

<sup>220</sup> Denoted  $\log[P(ECA|H_L)/P(ECA|H_P)]$

I summarise these two judgements in Table 8.1 which I will use later an update to the Prior Weight of Evidence for the rival hypotheses along with the intermediate plausibility evaluations in each world.

**Table 8.1: The Weight of Evidence from the compliance analysis favours legitimacy**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(ECA HE)	Implausible	$\frac{P(ECA HE)}{P(ECA HP)}$	In favour of HP	-3	0	-
P(ECA HP)	Somewhat Implausible					
<b>Legitimacy versus Power</b>						
P(ECA HL)	Very Plausible	$\frac{P(ECA HL)}{P(ECA HP)}$	Strongly in favour of HL	-	0	20
P(ECA HP)	Somewhat Implausible					
<b>Total Weight of Evidence from compliance analysis</b>				<b>-3</b>	<b>0</b>	<b>20</b>

\*NB. Note HP is used as the base case in each pairwise

These results indicate a strong judgement in favour of the Legitimacy hypothesis, that is, I consider that the evidence highlighted from my analysis of compliance is much more likely to have emerged as it has under the Legitimacy world view.

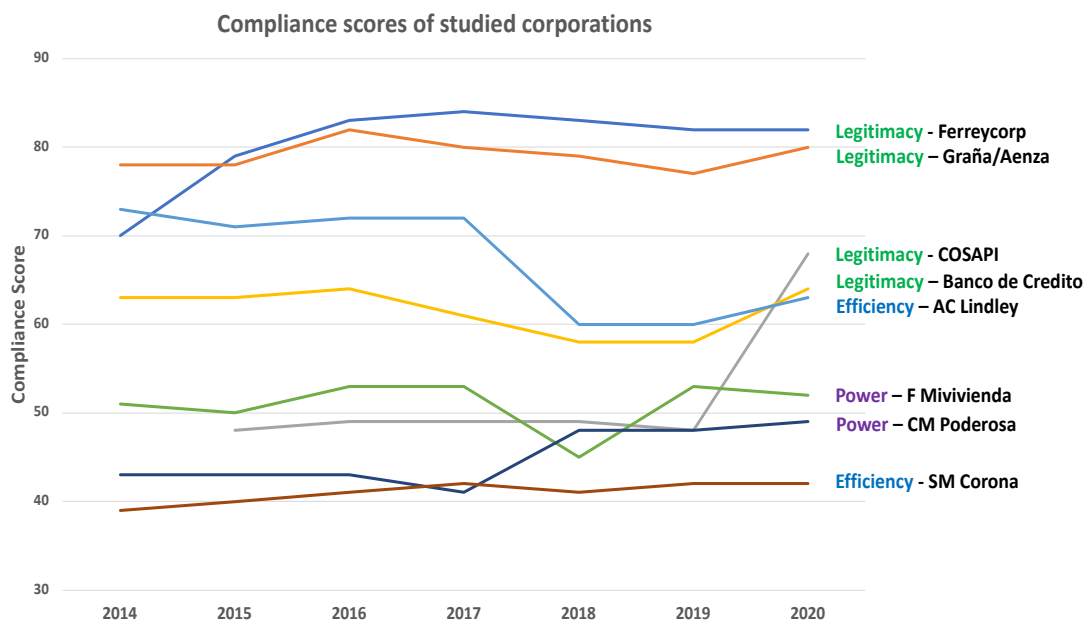
### 8.3.2 Highlighted evidence from case studies favours legitimacy-seeking

I have already used Bayesian Inference in the case studies in Chapter 6 to inform my judgement about the decision-making processes *for each corporation studied*. However, as I noted in §4.3.2, there is an issue about how to combine evidence from multiple case studies to establish an overall judgement about the rival hypotheses based on the accumulated evidence arising from the case study module. This is because there is additional evidence worth highlighting that has a bearing on the overall judgement that is not included in the

firm-level assessments. I had considered and rejected arithmetical manipulation of the individual case study results<sup>221</sup>. The additional evidence is the relationship between the corporations' approach to decision-making and their compliance with the code. I therefore re-evaluated the evidence from the case studies, including the *additional highlighted evidence of the impact of hypothesis use on compliance outcomes*, something possible from a macro-level analysis but missing from the micro-level.

The new highlighted evidence on firm compliance shows (in Figure 8.1) a clear association with my judgement on the prevailing decision-making approach regarding the code and corporations' compliance behaviour during the period 2004 to 2020.

**Figure 8.1: New highlighted evidence - Legitimacy is associated with higher compliance**



Source: Author's analysis of SMV returns and case study judgements  
 NB: I present Banco de Credito del Peru in lieu of Credicorp

<sup>221</sup> The three discarded arithmetic approaches: 1) sum weights of evidence from successive case studies – this would soon result in excessively large weights and risk over-favouring case study evidence; 2) treat successive case studies conditional on previous evidence. This would become arithmetically complex and would pose the risk of not reflecting potentially important differences between case studies; 3) take an arithmetic mean – this would be dependent on case study selection and the cases were not chosen to be representative. All would miss the additional evidence on outcomes.

Six of the associations are unequivocal: Ferreycorp, Graña/Aenza and Credicorp seeking legitimacy, with relatively high compliance scores; Fondo Mivivienda and Compañía Minera Poderosa expressing power, and Sociedad Minera Corona pursuing efficiency, all with much lower compliance scores. Two of the associations require some explanation. Firstly, I judged COSAPI to be legitimacy seeking with a trajectory of increasing compliance when I interviewed their executives in 2022; COSAPI's compliance had increased dramatically between 2019 and 2020 following the fall-out from the Construction Club and it remade its board and senior executive. Second, I judged AC Lindley to be efficiency seeking with a trajectory of reducing compliance following its takeover by Arca Continental in 2016 and the delegation of some of its governance to the new parent between 2017 and 2018.

### **Judgement of Weight of Evidence for pairs of hypotheses**

On the first paired comparison, *Efficiency and Power*, the highlighted evidence suggests that both hypotheses are associated with low compliance scores and that there is little to indicate a real difference between them in terms of the likelihood ratio. I therefore rate the Weight of Evidence in favour of  $H_P$  over  $H_E$ <sup>222</sup> as +0dB, to reflect the lack of discernible difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, the highlighted evidence suggests that there is a very clear difference in the compliance outcomes – the compliance scores for the corporations judged to be legitimacy-seeking are all high. All these corporations with high levels of constitutive rule compliance mentioned explicitly the effect that relationships with third parties had on their governance and their approach to the governance code. In contrast, the compliance scores of the corporations expressing power are all low. In the case of CMP, I made assumptions about the firm's thinking based on their

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<sup>222</sup> Denoted  $\log[P(E|E|H_E)/P(E|E|H_P)]$



board and committee structure and in the case of Fondo Mivivienda, the evidence was based on the MEF and FONAFE’s ambiguity over the status of INEDs. The rest of the evidence was neutral regarding this hypothesis. The evidence is therefore very much more convincingly to be expected in the world of the Legitimacy hypothesis and its association with higher levels of compliance. I therefore rate the Weight of Evidence in favour of HL over  $H_P^{223}$  as 30 dB to reflect the very strong difference between the likelihoods. I summarize these two judgements in Table 8.2.

**Table 8.2: The Weight of Evidence from the case studies favours legitimacy-seeking**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(ECS HE)	Neutral/plausible	$\frac{P(ECS HE)}{P(ECS HP)}$	No discernible difference	0	0	-
P(ECS HP)	Plausible					
<b>Legitimacy versus Power</b>						
P(ECSHL)	Very Plausible	$\frac{P(ECS HL)}{P(ECS HP)}$	V strongly in favour of HL	-	0	30
P(ECS HP)	Somewhat Plausible					
<b>Total Weight of Evidence from case studies</b>				<b>0</b>	<b>0</b>	<b>30</b>

These results indicate a very strong preference for the Legitimacy hypothesis; that is, I consider that the evidence highlighted from my tracing of decision-making and expression of governance through case studies is very much more likely to have emerged in the form it has under the Legitimacy world view.

### 8.3.2 Tracing developments in the institutional ecosystem favours the legitimacy hypothesis

<sup>223</sup> Denoted  $\log[P(E|E|HL)/P(E|E|HP)]$

In this section I discuss the evidence from the institutional ecosystem results in Chapter 6 to form a judgement about the rival hypotheses set out in Chapter 2.

I have highlighted evidence from each of the three chapter-sections: first, the organic strengthening of the local institutional market (§7.2); then Peru's institutional response to the global sustainability movement (§7.3); and finally, Peru's institutional response to the Odebrecht scandal (§7.4). I and highlight the key components of these in the discussion.

During the period 2014 to 2020 there was a marked strengthening of the institutional underpinnings required to support an active governance market in Peru which involved the BVL, the SMV, the pension funds and the AAFP, professional services organisations such as EY, and the leading Universities in Peru, all working somewhat in concert. These initiatives represent a blend of stick - the SMV improvement in standards and extra tough sanctions, the publicity over *La Voz del Mercado* - and carrot - increased bond facilities and more active institutional investment from the AFPs, and a growing cadre of INEDs. However, the carrot also came with additional obligations. In the world of the Efficiency hypothesis, this evidence would appear to be neutral, neither especially plausible nor implausible. Increased SMV sanctions could be construed as a driver, but I found no evidence of a firm receiving a sanction and a subsequent increase in their compliance subsequently. In the world of the Power hypothesis, the evidence is somewhat plausible because the tougher SMV rules could be seen as a response to early game-playing by corporations. This is, for example, likely to be the case in the clarification of the definition of the INED role, it may have been clear that some corporations were abusing this rule to have family members and others in INED positions - individuals who were clearly not independent either from management or owners. But if the SMV toughening had been effective, this would have thwarted the expression of negative power through such abuse. The evidence is somewhat more plausible in the world of the Legitimacy hypothesis where the reframed institutions are seeking to encourage firms to

increase their code compliance. For example, initiatives such as the AAPF providing directors in corporations in which the AFPs are investing would appear to be a cooperative venture based on improving governance, and this speaks to legitimacy-seeking on the part of the corporates.

Turning to the second bundle, COP 20 in 2014 appeared to have captured the attention of the Peruvian business community, and it is clear that Peru has embraced many aspects of the sustainability movement. One example is the rapid response by the SMV to add the Sustainability Report to corporations' duties, which although was made mandatory, occurred as several corporations were engaging with the GRI initiative. Perhaps more significant, were the growth and importation of several agencies providing evaluations of corporate behaviours which the corporations seem very keen to solicit reproduce in their annual reports as key aspects of their strategies. This evidence would appear to be entirely plausible in the world of the Legitimacy hypothesis because in every case, institutions are being established that broaden the relationship between corporations and the surrounding ecosystem, and this broadening seems to be both welcomed and responded to by corporations and one to which they appear to respond.

The highlighted evidence would seem to be unexpected in the world of the Efficiency hypothesis because there is likely no detailed cost-benefit case which would justify such behaviour. The highlighted evidence could be considered consistent with the world of the Power hypothesis where firms might be merely pretending merely to go along with the latest trends. However, given the nature of the sustainability reporting and the scrutiny that corporations are subjected to, by outsiders and by their own employees, along with additional burden of newly hired staff performing these new duties (probably younger and clear believers in sustainability), it is, on balance, difficult to see how the Power world explanation is credible.

With respect to the Lava Jato scandal, all the actions associated with corruption - the bribery, the manipulation of politicians, the manipulation of tendering processes and project scope slippage - were all very plausible in the world of the Power hypothesis, in which individuals acted with impunity (though ultimately to their personal cost). However, the reaction to the disclosures and subsequent legal proceedings is a different matter. As the epicentre of the Lavo Jato scandal outside of Brazil, Peru's business life and its wider society were shocked by the disclosures, the protracted period of litigation, and the prosecution of individuals. The reaction to the scandal, the prosecutions, the collapse of Graña y Montero, the creation of new anti-corruption agencies and the widespread adoption of ISO37001 by corporates are not to be expected in the world of the Efficiency hypothesis. The issues raised for corporate governance are much more powerful than a rule-based cost-benefit analysis which would be considered in that world. However, the highlighted evidence is plausible under both the Power and the Legitimacy hypotheses for different reasons. This evidence might seem reasonable in the Power world because firms would be likely to express mock outrage at the scandal to demonstrate their own innocence. However, as I showed in the case studies, the Lava Jato investigations also surfaced several other scandals - such as the Construction Club - and the implicated firms appeared to have admitted their failings and committed to a more ethical future. I have highlighted evidence of new and repurposed agencies, as well as new hard law, committed to curtailing corporate corruption and corporations have been seeking the examination and endorsement or certification of these agencies. The evidence therefore points rather to the end of much of the game-playing. In contrast, the evidence is reasonable in the world of the Legitimacy hypothesis, particularly in an emerging world in which corporations began to realise that the public and their workforces were more aware of corruption and more likely to speak out.

### **Judgement of Weight of Evidence for pairs of hypotheses**

On the first paired comparison, *Efficiency and Power*, some of the highlighted ecosystem evidence - in particular the response to the sustainability movement and to the Lava Jato disclosures - would appear unlikely to exist in the world of the Efficiency hypothesis but could, possibly, occur in the world of the Power hypothesis. However, it is difficult to imagine that this could be sustained, given the outspokenness of society and the stance of younger employees typically recruited to work on these issues. I therefore rate the Weight of Evidence to be in favour of  $H_P$  over  $H_E$ <sup>224</sup> as +10dB to reflect the clearly discernible difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, a significant component of the highlighted ecosystem evidence, especially the regulatory, societal, and corporate response both to the sustainability movement and to the Lava Jato disclosures, is by far more likely to emerge under the Legitimacy hypothesis because the new structures are designed to judge behaviours in terms of appropriateness and to confer legitimacy. Although it is possible to imagine these behaviours under the Power hypothesis, it does not feel sustainable because of the intense scrutiny being placed on corporations. I therefore rate the Weight of Evidence in favour of  $H_L$  over  $H_P$ <sup>225</sup> as 15dB to reflect the marked difference between the likelihoods.

I summarise these two judgements in Table 8.3, which I will use later to update the Prior Weights of Evidence for the rival hypotheses, along with the intermediate plausibility evaluations in each world.

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<sup>224</sup> Denoted  $\log[P(E|E|H_E)/P(E|E|H_P)]$

<sup>225</sup> Denoted  $\log[P(E|E|H_L)/P(E|E|H_P)]$

**Table 8.3: The Weight of Evidence from the institutional ecosystem favours legitimacy**

Likelihood	Plausibility Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(EIE HE)	Neutral/plausible	$\frac{P(EIE HE)}{P(EIE HP)}$	Clearly in favour of HP	-10	0	-
P(EIE HP)	Plausible					
<b>Legitimacy versus Power</b>						
P(EIE HL)	Very Plausible	$\frac{P(EIE HL)}{P(EIE HP)}$	Strongly in favour of HL	-	0	15
P(EIE HP)	Somewhat Plausible					
<b>Total Weight of Evidence from ecosystem evaluation</b>				-10	0	15

These results indicate a clear preference for the Legitimacy hypothesis; that is, I consider that the evidence highlighted from my examination of the institutional ecosystem is more likely to have emerged in the form it has under the Legitimacy world view.

#### **8.4 The updated judgement strongly supports legitimacy-seeking**

The protocol for updating successive tranches of evidence gathering allows for updating of the prior weight of evidence as each judgement about the new weight of evidence is formed, but I show the three sets of conclusions used to update the prior in one operation<sup>226</sup> in Table 8.4.

<sup>226</sup> Since the operation is addition, it makes no difference and there is little point in reflecting on the interim results after each single updating.

**Table 8.4: The posterior Weight of Evidence favours the Legitimacy hypothesis**

Components of Integrated Bayesian Inference	Weight of Evidence dB		
	HE	HP*	HL
<b>1) Prior Weight of Evidence (EB)</b>			
• EB: Strong theoretical background evidence for HP	0	20	0
<b>2) Updated by new evidence: ECA, ECS, and EIE</b>			
• Quantitative Analyses. ECA: Strong evidence for HL	-3	0	20
• Case Studies. ECS: V Strong evidence for HL	0	0	30
• Inst'al Ecosystem. EIE: Clear evidence for HL	-10	0	15
<b>3) Posterior Weight of Evidence</b>			
• Unadjusted or raw judgement	-13	20	65
• Normalized on HP = 0 (less 20dB in each case)	-33	0	45

\*NB. HP is used as the base case in each pairwise comparison

The table shows: part 1) the *prior* WoE of 20dB in favour of HP, which I based on the background information gained from the literature here designated EB; part 2) the *updating* of this prior by three successive additions of WoEs from the highlighted evidence ECA, ECS, and EIE; giving in part 3) a *posterior* WoE based on summation of the decibel scores in each column.

I first expressed this posterior as a ‘raw’ or unadjusted result, and then as a normalised result with HP set to zero because it is the reference hypothesis. The conclusions extremely strongly favour the Legitimacy hypothesis over the Power hypothesis and very strongly disfavour the Efficiency hypothesis.

I have used Bayesian updating here without assuming any interdependencies between the three tranches of highlighted evidence, This means two things: first, that the judgement

about the highlighted evidence from the institutional ecosystem can be made independently of the judgement about the highlighted evidence from the analysis of compliance, and second that the judgement about the highlighted evidence from case studies can be made independently of the judgement about the highlighted evidence from the institutional ecosystem, *and* of the of the judgement about the highlighted evidence from the analysis of compliance.<sup>227</sup> It could be argued that the three tranches of research are connected if only by their subject matter, but this is not a convincing argument since I have highlighted just that evidence which clearly discriminates between hypotheses. It is therefore in terms of these evidence bundles that the interdependence must be considered. I have made the judgement that these tranches of evidence are independent, and so the three sets of results are independent of each other, not materially coupled, and so not in need of further adjustment. However, I have carried out a realistic sensitivity assessment, that is that the conditional probability of successive tranches of evidence is raised, and so the weight of evidence should be reduced by a material amount. Under this regime, my conclusion that the Legitimacy hypothesis is most associated with high compliance is robust.<sup>228</sup>

## **8.5 An elaborated theory to explain corporate decision-making**

### **8.5.1 Introduction**

I have demonstrated that legitimacy-seeking is the form of decision making most associated with high levels of compliance amongst listed corporations, and that the Efficiency and Power hypotheses are more likely to be associated with lower levels of compliance. In this section, I will develop a theory for legitimacy-seeking in the governance market and in

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<sup>227</sup> Or indeed in any of the six possible permutations of order

<sup>228</sup> As a sensitivity, I examine the effect of reducing both the second and third updates by 10dB, a *clear* down weighting of each of the second and third WoEs. This would reduce the final differences in WoE for HL relative to HP by -20dB to yield an outcome of +25dB, a conclusion still *strongly supportive* of HL.

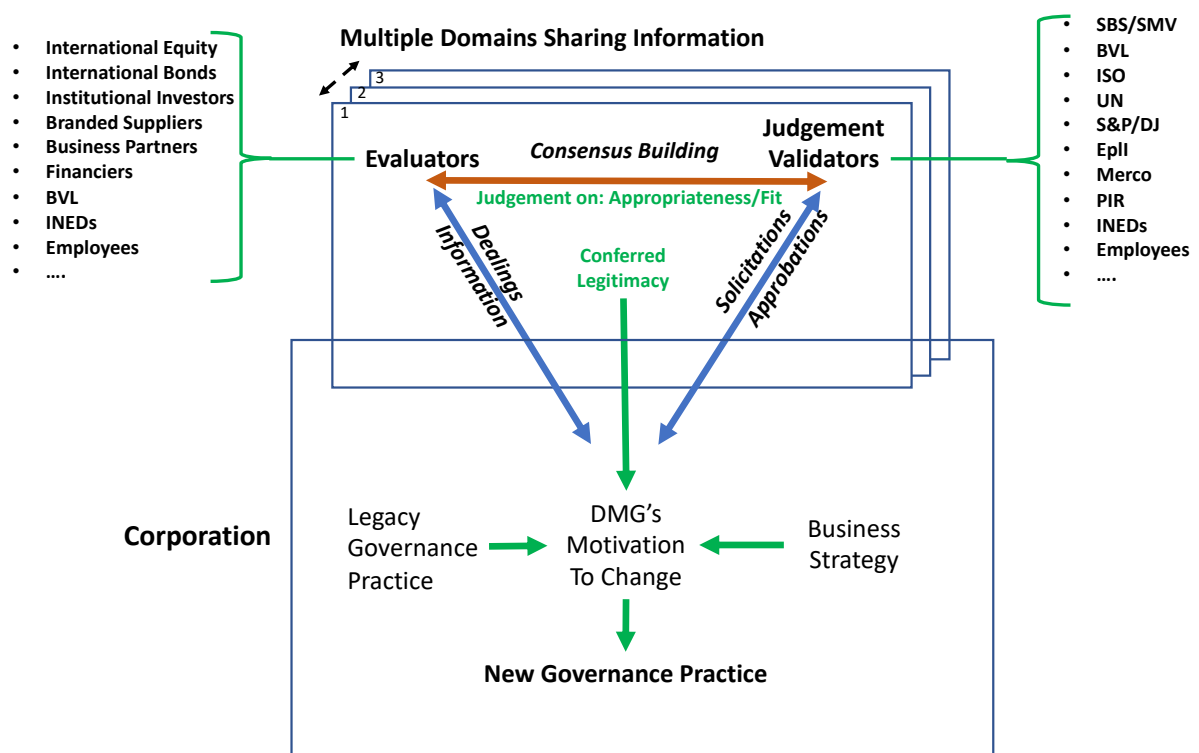


§8.5.3, I will set this discussion in the wider context of the four components of theory which I established in Chapter 2.

### 8.5.2 Legitimacy-seeking in the governance market

I have combined the theoretical and empirical insights developed thus far into a reframed model in Figure 8.2 to describe the process of legitimacy-seeking employed in the Peruvian governance market.

**Figure 8.2: A new model for legitimacy-seeking in the Peruvian governance market.**



Corporations seek legitimacy in multiple domains comprising the entities in which Evaluators and Judgement Validators are located, whose interactions and information exchange is indicated by the triangle at the top of the figure.<sup>229</sup> The identities of Evaluators and Judgement Validators shown are all derived directly from my research. The framework is

<sup>229</sup> Note this is not the Governance Triangle of Abbott and Snidal (2009) but provides a more nuanced framework based on roles by introducing a third-party Judgement Validators into the Evaluator-Corporation relationship.

very relevant to the governance market because the SMV and the SBS<sup>230</sup>, are crucial Judgement Validators working in the governance market using information provided by the corporation regarding its compliance with the code. Moreover, this information is used by Evaluators in other firms, especially in financial markets and investors that do business with the corporations, to contribute to their decisions about whether and how, or at what price, to deal with the corporation.

Corporations wish to have dealings with the firms represented by Evaluators in the normal course of their business. These partners need to form judgements about the corporation, and this is the role of the Evaluators who use information from the corporations to make their judgements. However, this process occurs with a degree of bounded rationality, so additional information is used to help evaluator firms make their judgements. Some of this additional information is provided by Judgement Validators. These are agencies either pursuing their own commercial business model<sup>231</sup> or lobbying for a cause.<sup>232</sup> They engage with the corporations to make evaluations of some aspect of the corporations' behaviour, or of the validity of a business process. Often in return for fees, the Judgement Validators provide various forms of approbation to the corporations, which could be prizes, certifications, public endorsements, or other publicity. These approbations are used by Evaluators as additional sources of information on which to make their own business judgements.

I will elaborate here on the key features of this framework, including: the process by which legitimacy is bestowed on the corporation; the arena for action being a domain; how agents in the social sector play specific roles in building a consensus judgement on the acceptability of corporations' behaviour; the role of information flows in building consensus;

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<sup>230</sup> I have not included the SMV and the SBS as Evaluators because they are not 'in business' with corporations in the manner of the BVL.

<sup>231</sup> Such as selling certifications, credit ratings or advisory services.

<sup>232</sup> Such as anti-corruption or sustainability.

the importance of operating in different domains with bounded rationality, and the opportunity this creates for governance information; the role of equifinality and the nature of governance as an institution.

### **Legitimacy bestowal is a negotiated process, often mediated by price**

Legitimacy is bestowed on a firm by a process involving information flows and negotiation between the firm and third parties each with their own agenda. Legitimacy is not solely manufactured by the corporation. Legitimacy can, like reputation or a brand, be lost, and I provide several examples of this in the case studies in Chapter 6 and Appendix 6.2, notably Graña y Montero, COSAPI, Credicorp, and Arca Continental Lindley, who have all had difficulties with scandals that have caused reputational damage to varying degrees of cost, to the corporations concerned.

In the governance market, the bestowal of legitimacy is a negotiated process and takes place with bounded rationality. In one model of bestowal, Stinchcombe posited legitimacy was bestowed by powerful influencers which were not influenced by the firm. The case studies show that several of the important agents from whom a corporation might seek legitimacy are financial institutions where acceptability is not a binary process, but rather a matter of negotiated pricing. In some cases, for example with Fondo Mivivienda, the firm was prepared to accept higher rates for its capital rather than improve its governance. In other cases, such as that of Ferreycorp, the firm is very conscious of maintaining a perception of good governance because it will affect the pricing of future, yet unplanned, bond issues. Bounded rationality also plays a role. In the market for finance, perhaps there is good information available, but it is clear regarding the Sustainability Report that corporations are operating in an immature market where the frameworks and quality of information particularly regarding environmental measures have not yet settled down. This further adds to the negotiated nature of legitimacy in these areas. Legitimacy has spill-over effects also.

## Agents operate in Domains, comprising audiences for corporate information

Legitimacy has been seen by other authors as bestowed by actors operating as organisations operating either in a Field<sup>233</sup> or in a Social Sector<sup>234</sup>, where the agents of interest are all external to the corporation. I would argue that a more appropriate framing is the Domain, in which a group of interested agents act as distinct audiences for information irrespective of *whether they are inside or outside* the corporation (Hannan, Pólos and Carroll 2007: 34). The case studies showed that the important actors are by no means all organisations, nor are they all external to the corporation; some of the key agents as audiences are *inside* the corporation as general employees, or as occupants of the many new roles that have been defined by the governance code in the process of ‘changing the game’ through introducing third parties into governance. These new roles include INEDs; heads of compliance; heads of sustainability; heads of ethics; board appraisers; training staff engaged with promulgating compliance; ethics and sustainability; people responsible for whistle-blower channels; as well as the bulk of general employees receiving training and now alerted to a new dimension of corporate life as their employers add new sections to their annual reports and corporate websites. This emphasis, in the Domain, on roles rather than identities, is crucial because of the inclusion of employees as an important audience and third-party observer, and as a participant in the governance process. Moreover, respondents working as heads of sustainability were very aware that a large proportion of their employees were younger than corporate directors, and so will have different values and attitudes regarding

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<sup>233</sup> The Field consists of “*those organisations that, in aggregate, constitute a recognised area of institutional life: key suppliers, resource and produce consumers, regulatory agencies, and other organisations that produce similar services and products*” (DiMaggio and Powell 1991[1983]: 148).

<sup>234</sup> The Social Sector is “*a collection of organisations operating in the same domain, as identified by the similarity of their services, products, or functions, together with those organisations that critically influence the performance of the focal organisations: for example, major suppliers and customers, owners and regulators, funding sources and competitors*” (Scott and Meyer 1991: 117).

issues such as sustainability and corruption – in short, they will be more demanding of sustainability and less tolerant of corruption (Respondents 24, 31 and 37).

### **New agentive roles have emerged with deontic responsibilities**

My research on the emerging institutional ecosystem and the case studies confirmed the existence of two distinct types of agentive function in the corporate market. The first are agents, which need to deal with the corporation in order to provide or receive a content-based service and are ‘in business’ with the corporation. The second are also in business, but their role is to sell their own service which consists of an evaluation of some aspect of the corporation. These distinct agentive functions correspond to those identified as Evaluator and Judgement Validator respectively by Bitektine and Haack (2015).

The Evaluators identified in this research include international stock exchanges such as LSE and NYSE; international bond exchanges such as New York and Luxembourg; institutional investors including the Peruvian AFPs, as well as international funds; branded suppliers such as Caterpillar and Coca-Cola; business partners, in particular financiers of infrastructure projects; the local exchange, the BVL; and the INEDs and the internal groups of individuals mentioned above. All these groups need to decide about whether or not to engage with a corporation and, in some cases, to risk their own reputation. The INEDs and employees play a dual role: they are Evaluators to the extent that they need to form their own judgements about how and whether they work with a corporation and, they are also Judgement Validators because they generate information of value to other Evaluators. For example, INEDs with reputations in the governance market or previously as executives operate as Judgement Validators for the signals that they send out to other audiences regarding their personal participation in the business,<sup>235</sup> for which they are known and

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<sup>235</sup> It is no small matter for an INED with an international reputation to serve on the board of a firm recovering from a recent scandal.

observed. The INEDs I interviewed were very aware that they may have been recruited specifically to contribute to the positive perception of a corporation, especially if they have their own international reputation, and so were very keen to ensure that any reputational issue was either resolved or contained (Respondents 1, 22, 38, 39 and 42).

The main Judgement Validators in the governance market, as identified in this research, are the SMV, SBS and the BVL. Both regulators provide information to the wider market on corporate compliance as well as, in the case of the SBS, the issuance of a licence to operate, which is taken by others as a mark of a corporation's adequacy to operate as a financial institution. The BVL also acts as a Judgement Validator by publishing information on high compliance corporations, running competitions for good governance, and working in collaboration with EY to produce the annual survey of financial market opinion *La Voz del Mercado*. All this information is potentially available, whether directly or processed through corporate reports, independently published and via social messaging, for Evaluators to use as they see fit.

In addition, I have identified several other Judgment Validators in the research which have grown in activity and number in Peru between 2014 and 2020 and which I described in Chapter 5. These include the international ISO through the production of several standards for business processes, anti-corruption (ISO37001), and sustainability reporting, the UN through their SDGs which are adopted in part or whole by corporations as a framework for their own work; Standard & Poor's/Dow Jones, for its Sustainability Index which highlights the work of a handful of Peruvian corporations, most notably Ferreycorp; *Empresarios por la Integridad* which certifies corporations it considers free of corruption; Merco who provide reputation evaluation services, and produce named lists of reputable individuals and corporations, beyond the listed sector; *Principios por la Inversión Responsable*, who influence institutional investors, and who have contributed to the SMV's framework for

sustainability reporting; WomenCEOPerú who are promoting different individuals into corporate governance; *Capital Consciente*, PerúSostenible, and CONFIEP with its 32 members and chambers of commerce, who fight corruption in partnership; on the negative side, CPA, whose mission is to expose individuals accused of nepotism and corruption; and finally, the INEDs, and the host of employees who are now much more vigilant than in the past.

The case studies confirm that the corporations with the highest levels of compliance actively solicit the attention of multiple Judgement Validators to endorse their internal processes and as a source of certificates and other forms of approbation for which they often pay a fee. Judgement Validators have new deontic responsibilities; although they pursue their own goals, they also owe a duty of care to the users of both the information that they produce, and the signs that they create through the conferral of awards, rankings, and certificates on the corporations that they assess. Bitektine and Haack (2015) describe a world in which Judgement Validators and Evaluators work together to create a domain-based consensus judgement on the corporation in question. This has not been observed explicitly in this research but would appear to be a good working hypothesis because several corporations in the case studies were very enthusiastic about securing endorsements from Judgement Validators, while also asserting that they did not explicitly take action to improve governance to secure such endorsements. These corporations were keen to publicise the awards in their annual accounts and to their employees.

### **Multiple domains and bounded rationality help leverage governance information**

The triangle pictured in Figure 8.2 is an attempt to simplify a complex interchange of information in an idealised relationship between the three groups in each Domain. There will likely be multiple Domains operating in parallel; for example, Ferreycorp operates in what could be described as the equity domain, in which the corporation is engaged with its

market placements, the trading turnover, equity pricing, international investors, and the possibility of raising new equity. Ferreycorp's financial statements will be a source of information which will be key to these audiences, but so will governance information, as the case study implies. At the same time, they are engaged in the operation of their business, and in their relationship with Caterpillar and multiple other global branded suppliers who will be imposing their own performance criteria onto the corporation and who will also be interested to understand how Ferreycorp's board governs the business. Other corporations will have similar, though differentiated, experiences. COSAPI may share some of Ferreycorp's domains but will also be engaged in finding business partners for new construction projects who can provide project-based finance, and perhaps also specialised construction expertise. Some of these partners may be long-standing but others may be new and keen to see how COSAPI's governance has changed since its collusion in the construction club. Each of these Domains could be using information about Ferreycorp's and COSAPI's code compliance, and latest ISO ratings; reading what they say about how they conform with the UN's SDGs; looking at the Merco rankings; and checking whether they are in the S&P/DT ratings or have just won a certification from EplI.

It is not just that a corporation is *sending out* a lot of information to the decision takers in Evaluators and to the Judgement Validators, the information they receive *is* the corporation, in the sense that there is *no other relevant aspect of the corporation that is not* encoded as information. This coincides with the theory of the corporation as a semiotic entity that communicates through signs and symbols with multiple audiences, a theory developed by Bau-Mercado and Herrmann-Pillath (2021).<sup>236</sup>

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<sup>236</sup> There are four principal alternative theoretical constructions of the Corporation: Corporation conceived as a legal fiction, essentially a nexus of contracts (Jensen and Meckling 1976); corporation as real entity, a social fact emergent from social structures (Chassagnon 2014); corporation as an agentive function assembling a bundle of knowledge and competences (Nelson 1991); and corporation as a semiotic entity in communication through signs and symbols with multiple audiences (Bau-Macedo and Herrmann-Pillath 2021)



However, information flows and how they are interpreted are not likely to be perfect, and so there will be redundancy; Evaluators will collect more information than they strictly need. There will be such bounded rationality for two reasons, first because there will be imperfect information for Evaluators to make perfectly informed judgements and, in any case, there may be discrepancies between different sources, and second, it may not always be clear to Evaluators what pieces of information mean in practice, that is, they will lack the ability to adequately process or to interpret some information. For this reason, information that is perceived to be of high quality may be used for reasons other than originally intended. In this maelstrom, the research has shown that corporations with high compliance consider governance information to have value for the various audiences in multiple Domains. A priori, this makes a great deal of sense: in a world of bounded rationality, a regular flow of detailed information published and commented on by a body such as the SMV would likely have intrinsic value and authority.

The description above of corporations operating in a cloud of information which is being scrutinised by multiple audiences adds a further dimension to the evidence for equifinality provided in the research modules. Not only is the specific combination of factors different for each company, but the information that drives the communication between corporations, Evaluators and Judgement Validators will be subject to some level of imperfection and misinterpretation, thereby increasing the extent of equifinality. How Evaluators *actually* use information from corporations and Judgement Validators to take their decisions was not observed in the research beyond the claims of executive and professional respondents that this information was valued. However, the Domain logic of Hannan, Pólos and Carroll (2007: 34) suggests that agents - here Evaluators, use information to judge *similarity*<sup>237</sup> - that is, to judge whether a corporation under evaluation is similar enough to

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<sup>237</sup> Hannah et.al. use Tversky's (1977) contrast model to measure similarity.

those that have already passed evaluation (2007: 37). In this framing, the potential role for information on governance is enhanced – if the existing corporations that are judged to be good investments have high compliance, as well as other endorsement, this same level of endorsement is considered the norm and would be expected - another form of norm cascade. Judgement Validators may also use similarity as a metric, but I assume that they are operating in a more restricted frame of reference and have evolved their own rubrics suited to the limited scope of their evaluations and smaller down-side risks associated with their interventions.

Legitimacy-seeking in a multi-domain environment has positive spill-over effects for the corporation. Bestowed legitimacy acquired in one domain can have benefits in another, as if the Evaluator in the first domain acts in the role of Judgement Validator in another. Ferreycorp saw clear advantages to its relationship with Caterpillar not only in the same domain in helping it secure agencies with a score of other leading branded equipment suppliers but also in maintaining itself ready for further international bond issues.

#### **8.5.4 A wider theory of governance decision making**

In this section, I will discuss the remaining components of the theory of corporate decision-making that I set out in Chapter 2, including the role of the legitimacy outside the governance market; developments of the Power and Efficiency hypotheses in corporate decision-making; the coexistence of rival explanatory hypotheses in each corporation; constitutive rules as the main area of contestation; and the presence of equifinality in outcomes. Throughout the three research modules, I have identified evidence to address these topics, which I recap this here for ease of reference (Table 8.5).

**Table 8.5: The new theory draws on evidence comes from all three research modules**

Component of theory (Chapter 2)		Research module and contribution to theory		
		Quantitative (Chapter 5)	Ecosystem (Chapter 6)	Case studies (Chapter 7)
<b>1. Relevance of three hypotheses to decision-making</b>	<b>Legitimacy Seeking</b>	Quantified evidence for strong association of high compliance with outside and situational factors. No quantified evidence to distinguish between hypotheses. But surges, equifinality etc may be highlighted.	Sustainability implies corporations increasingly need to seek legitimacy from a wide array of stakeholders. Also, develops original concept - role of judgement validator emerges as part of consensus building	Clear evidence that legitimacy seeking is an important concern for corporations. Applied to the code, it is associated with high compliance firms, but also exists in other areas of governance. Also, develops original concept of legitimacy seeking – it is a negotiated process and one where judgement validation is sought
	<b>Power</b>		Suggestive that misdemeanours, corruption, deceit are not acceptable	Evidence for duplicity in presentation of constitutive rules re INEDs. Relevant for lower compliance firms
	<b>Efficiency</b>		Suggestive that corporations need to widen their remit beyond mere economic efficiency.	Evidence for efficiency. Also, develops original concept - where corporation is reduced to an operating unit with governance delegated to parent. Relevant to lower compliance firms
<b>2. Contestation over constitutive rules</b>		Clear evidence of lower compliance with constitutive rules indicating these are the rules contested	Evidence that constitutive rules have required most support in terms of institutional development eg INED role-definition and INED training	Clear testimonial and documentary evidence that constitutive rules are the focus of internal debate and considered the focus of ‘good’ governance
<b>3. Coexistence of three hypotheses</b>		-	-	Evidence for multiple hypotheses highlighted in some companies
<b>4. Equifinality</b>		Clear evidence from factor analysis, MLR (interactions) and csQCA (INUS combinations of conditions)	-	Clear evidence of differing circumstances driving similar behaviours and high compliance

### **Legitimacy-seeking occurs outside the governance code**

I have discussed the role of legitimacy-seeking with reference to the governance code and for situations where information on a corporation's compliance may be of value. However, legitimacy-seeking is a common practice, and I observed this in other areas of business practice in the case studies. The two mining case studies illustrate this. Both Sociedad Minera Corona and Compañía Minera Poderosa have low code compliance especially regarding constitutive rules and are examples of the Efficiency and Power hypotheses respectively. Both were found to use Legitimacy Seeking regarding their dealings with mining regulators and local communities over social and environmental management. These are areas where it might be that information on governance could be deployed but for the audiences in question other information is required – i.e. technical information for the regulator and a clean environment and social engagement for the local community. In these contexts, the model I presented in Figure 8.2 might apply but I suspect that the communication between the miners and these audiences (as Evaluators) is more direct; the mining regulators are experts dealing with a bounded entity in the form of the mine and may and not need Judgement Validators, while the local community may have Judgement Validators which operate in a less formal manner than, for example, ISO, S&P/DJ or Merco.

### **Developments to the Power and Efficiency hypotheses.**

The Power and Efficiency explanatory mechanisms have also been somewhat transformed through the findings from the research although perhaps not as much as the Legitimacy mechanism. My original conception of the Power hypothesis was that it would represent an overall stance towards the code and that it might be expressed in a strategy of

gaming the code in some way. From the evidence gathered, it seems to constitute a pattern of misrepresenting important constitutive rules which are particularly undesirable for the firm, but with which it is advantageous to be seen to comply. Also, it is important to draw a distinction between evidence of corruption in a corporation - a clear expression of the Power hypothesis in its business dealings - and evidence for the Power hypothesis in play in relation to the governance code. The case of Graña y Montero illustrates this well; the firm apparently stopped its corrupt practices in the same year that the code was introduced. This may be a mere coincidence, but it is not evidence that the code was being undermined by ongoing bribery of government officials, and it is important to note that the code does not cover bribery or corruption - that is left to hard law and ISO standards, and to vigilance by INEDS. There is certainly weight to the counterargument that the introduction of the new code was a good reason for discontinuing bribery. Beyond speculation about Graña y Montero, I did not find evidence for high-compliance companies using the Power hypothesis – no doubt at the margin, corporate leaders may use high compliance as a measure of ethical behaviour and seek to take advantage, but I consider this to be ad-hoc opportunism rather than a sustained strategy, the effort to secure high code-compliance would likely not be worthwhile.

The Efficiency hypothesis was originally taken to be a rigorous approach to cost-benefit analysis based on an instrumental logic. No evidence for such behaviour was found at the level of detail or specificity implied in the original theory and respondents who served as Finance Directors denied any such practice. I did find evidence of the consideration of economic efficiency operating at a broader level, but as part of a wider approach to business and organizational strategy and not the imposition of a micro-level accounting practice. In both of the two firms included in the case studies, this was the result of an acquisition; in the case of Arca Continental's acquisition of Corporación Lindley, the latter experienced a reduction in code compliance as Arca took over some of its compliance functions; and in the

second case of Sociedad Minera Corona's acquisition by Sierra Metals, and the delegation of governance functions to the parent was used as the 'explanation' for non-compliance in a small mining company, which had probably never had those delegated governance functions before the acquisition.

Similar decision-making can be seen in the high-compliance firms that make contingent decisions based, in part, on financial grounds when deciding how to deal with multiple divisions, whether in Peru or in other countries. For example, Ferreycorp decided to operate its business divisions with limited governance functions even though they are in different countries, whereas Credicorp operates separate subsidiaries with their own boards and SMV reporting, even though their business operations are all located in Peru. These decisions are not purely financial; they are to some extent path dependent based on how the business was established – by organic means in Ferreycorp's case and by acquisition for Credicorp.

**All three hypothesised mechanisms remain available on a contingency basis.**

The assertion that all three explanatory mechanisms coexist in each corporation seems at first like a technical issue, but it is important to recognise that all corporations have the capacity to deploy these mechanisms. Some firms with higher levels of compliance deploy legitimacy-seeking with respect to the governance code, but also with respect to other audiences in their domains. Firms with low compliance clearly choose not to seek legitimacy with respect to the code, because it is not material to the audiences they wish to impress, preferring to seek economic efficiency say, but do seek legitimacy in other ways from the audiences that they value in their domain. This is illustrated by the mining companies, which clearly valued the local communities where they mined, and provides a variety of community support and engagement. These firms were therefore combining Power and Legitimacy mechanisms, or Efficiency and Legitimacy mechanisms, each in their different domains. In

addition, the description of Ferreycorp and Creditcorp showed two examples of corporations that had combined legitimacy-seeking with other considerations probably including economic efficiency. It would seem unlikely however, for a corporation to combine Legitimacy Seeking with Power since this would appear to be contradictory.

### **Constitutive rules are the most contested.**

I have identified evidence that the constitutive rules are more contested by corporations in all three research modules. The analysis of compliance shows that compliance with constitutive rules is much lower than for regulative rules, both at the population level and for every single listed corporation, and consequently the distinguishing feature of a high compliance corporation is its high level of acceptance of constitutive rules. The explicative power of exogenous factors in the MLR was clearly higher for constitutive rules suggesting that external agents have influence over firms' constitutive compliance. Further evidence comes from the ecosystem research where I highlighted the work done by the SMV to recast the role definition of the INED, and that done by universities to offer INED training to increase the stock of candidates. It was also confirmed by the case studies in which discussion of constitutive aspects of the code dominated my conversations. This conclusion is crucial because the constitutive rules are changing the 'game' of governance by including new 'players', i.e. the agents identified above, particularly the INEDs, board evaluators and whistleblowing employees as well as the other Judgement Validators. Although the code has been in operation for less than a decade, combined with the mandatory Sustainability Report, it is the 'thin end of a wedge' in terms of changing corporate culture in Peru.

### **Equifinality is a feature of the dispersed nature of governance as an institution.**

My assertion of equifinality in Chapter 2 was strongly supported by the analysis of compliance and was present in all the analyses used. It was one reason why the topic was tricky to analyse; there were so many possible configurations of factors driving behaviour

which were borne out by the case study interviews. Equifinality was also clear from the case studies, where I described the unique circumstances of each business and how they had found ways to incorporate their approach to the governance code with their business strategy.

This conclusion is important for two reasons: first, from a policy perspective, there is no ‘silver bullet’ that can be used to transform governance; second, from a theoretical point of view, it helps to define the nature of corporate governance as a dispersed economic institution.

## **8.6 Conclusions**

In this chapter I have drawn together my prior judgement about the hypothesised mechanisms influencing corporate decision-making with regards to the governance code, and I have updated it with a substantial body of research material, to form a view of how the hypothesised mechanisms are associated with corporate compliance. I then combined this with pertinent theories of the corporation to develop a new theoretical framework which focuses on explaining how corporations in Peru seek, may be awarded, and possibly might lose legitimacy for their behaviours in an institutional context which, while not favourable in 2014, has since developed sufficiently to provide pertinent approbation and censure alike.

In the concluding chapter, I will address the question of whether this research has provided a sufficient explanation of corporations decision-making processes regarding the governance code and crucially, whether the initiative is likely to have any impact on de facto corporate governance practice.



## **Chapter 9                      Conclusions**

### **9.1      Introduction**

In this chapter, I present my reasons for concluding that this thesis provides a robust theoretical and empirical explanation for corporations' compliance with the 2014 governance code in Peru. I will then address the question of whether paper compliance with a voluntary governance code in a civil law jurisdiction such as Peru will make any impact on the practice of corporate governance in the country and, crucially, whether, despite it not having been my focus, we might expect to see a more widespread reduction in corporate corruption in Peru.

I conclude that corporations with exposure to the factors explored in Chapters 5 to 8, such as international financial markets and value chains, are willing to trade greater transparency of their corporate governance for legitimacy and that because of the involvement of third parties and their own employees, such a stance is likely to persist. However, the same cannot be said for the wider corporate market not willing to make such a bargain, and I make no claims for any general reduction in the level of corruption in the country which as Quiroz and Diego note is an embedded part of Peru's history and culture (Quiroz 2008: 432, Diego 2016).

### **9.2      Legitimacy-seeking as an explanation for governance code compliance**

My theoretical starting point was to treat the newly implemented corporate governance code as a new institution imposed on the essentially informal institutions of autonomous corporations listed on the BVL. I used Searle's general theory and neo-institutional literature to confirm that the 2014 governance code exhibited all the characteristics of an institution, could be described as a dispersed economic institution, and would likely have most impact on the governance of corporations to the extent that it contained constitutive rules for best practice, which would introduce new participants into

corporations' governance processes. In this way, the code was offering the potential to do more than change the 'rules of the game' of governance, but to change the 'game' itself by assigning new deontic roles and responsibilities to existing participants, and, crucially by introducing new participants. Perhaps the most important of the new agents to be introduced into corporate governance with the potential to change the game, are the independent directors (INEDs) with no vested interests other than their own professional reputations, and the de facto inclusion of employees.

Further exploration of the theoretical literature led to the development of three rival hypotheses to explain firms' decision-making. Two of these derived from neo-institutional literature and one from the business regulation literature, namely Efficiency, Legitimacy, and Power. Each is based on an array of situational and exogenous factors and agents that in some ways, whether from the literature or from experience, showed potential for shaping corporate behaviour towards compliance. These three mechanisms and their respective agents were integrated into a single causal framework to allow for the possibility that all three mechanisms were potentially deployed in a single firm.

Evidence collected during the research provided very strong support for a form of the Legitimacy hypothesis, that is, that corporations with higher-than-average compliance with the code, basically seek legitimacy and approval for their governance practice from a selection of agents which they perceive to be important in their commercial and regulatory environments. I modified the initial hypothesis to acknowledge that corporations are in the main not subject to coercive relationships, but they are subject to negotiated relationships with agents with whom they choose to deal, and where they have some degrees of freedom and the potential for other options – as well as to reflect very specific agentive roles that were emerging in Peru. I also observed the Power and Efficiency mechanisms in practice and

modified these hypotheses also to be consistent with the empirical findings, that both are associated with lower levels of code compliance.

My analysis of data from the SMV confirmed that it is the constitutive rules that make a material change to the participants and/or their roles in the corporate governance process and which are the most contested, and which therefore receive received a significantly lower level of compliance from reporting corporations. This finding is consistent with Searle's general theory and with common sense – that the inclusion of third parties into what was previously a relatively private affair would be resisted by controlling shareholders. I therefore placed compliance with constitutive rules at the core of the investigation.

The evidence from both the analysis and the case studies demonstrated the importance of several situational and exogenous factors that had an influence on an individual corporation's compliance and on the role played by both internal and external agents. The situational factors included having a strong reputationally concerned player in the firm's value chain - whether this be a supplier, project partner or regional or international owner - or having been involved in a scandal such as the Construction Club, which concluded with a material damage to the corporation or its leaders and acted as a spur to self-improvement. The exogenous factors include participation to a high degree in local equity markets, participation in international bond or equity markets or having the additional supervision of the financial services regulator. Each of the factors explored in the quantitative analysis was associated with an external agent with its own Evaluators establishing judgements about corporations of interest. Each of the factors had a material association with compliance but a combination of just six factors accounted for almost one half of the variance between firms in their compliance with constitutive rules. Analysis of combinations of factors supported the claim that there was equifinality, that is, that there are multiple ways in which corporations can be exposed to the situational and exogenous factors leading to high compliance with

constitutive rules. Nevertheless, because of the history and composition of the BVL, there are many firms that are not interested in raising external finance or providing a significant float which is actively traded, and these firms exhibit relatively low levels of compliance overall and especially so with constitutive rules.

In parallel, despite not being the case at the launch of the code in 2014, by 2020 a growing institutional ecosystem had developed comprising agents playing the role of Judgement Validators. Endogenous factors include a strengthening of the institutional investor base; strengthening of the local stock market through bond issuance; growth in an INED training market; new tougher leadership of the SMV; introduction of improved definitions of independence and of the INED role; and the adoption of frameworks promulgated by international agencies to establish local chapters in Peru. Exogenous factors include the rise of the sustainability movement post COP20 in Lima in 2014 and the shock to the corporate market in the form of disclosures triggered by investigations into the Odebrecht corruption scandal, which then led to the creation of agencies promoting anti-corruption, sustainable investment, and sustainability practice in corporations. The findings provide a rich description of how the governance code has been transformed into an important component of a wider framing of corporate governance - which includes a broad definition of sustainability and ethical behaviour - and of how these values have become embedded as institutional facts involving a wide array of stakeholders including owners, suppliers, partners, employees, and clients.

In Chapter 8, I provided an enhanced theory for how corporations respond to the introduction of a new governance code in Peru. In this model legitimacy is bestowed on a firm through a process of negotiation between the firm and third parties, where judgement-formation involved different groups of agents, each with their own agenda. Evaluators need to form a judgement because their organisation has dealings with the corporation in question

and they need to decide whether, how and at what price to engage with it. These individuals' task is to frame a judgement based on information received in part from the corporation itself so as to form their own organisation's collective view on the transaction or relationship. In return, the evaluators' organisations provide engagement to the corporation, whether this be in the form of an equity issue, a particular bond pricing, a business partnership or ongoing provision of products and services. These Evaluators also rely on the contribution from other groups playing the role of Judgement Validators who again use information in part provided by the corporation, alongside other information such as the firm's preparedness to undertake modifications to internal processes, to validate emerging judgements about the firm. In return, Judgment Validators provide the corporation with an external manifestation of their work whether this be a certification, an ISO designation or mention in an awards ceremony for good governance. Evaluators and Judgement Validators both contribute to form a consensus view which is used by the evaluators' organisation to engage with the corporation.

A corporation may be involved in several different negotiation processes in different domains involving different Evaluators and Judgement Validators. However, because the information provided by Judgement Validators is in the public arena along with the corporation's dealings with the organizations of multiple evaluators, the various judgements form part of a wider consensus on the firm, its governance its credit rating and commitment to sustainability. Corporate governance in general, and compliance with the 2014 code in particular, have become a part of this broad judgment formation and consensus building process.

The evidence presented here and the description of a new theoretical model for legitimacy-seeking provide a robust theoretical and empirical explanation of the processes and agents that impinge on corporate decision-making with respect to corporate compliance

with the 2014 governance code in Peru, and that integrates theoretical and empirical considerations.

Yet, to what extent does mere compliance with the code extend beyond form filling? In other words, is compliance with a code of conduct likely to have any impact on improvements in actual governance practice, can the code be relied upon by international actors as an indication of corporate integrity and ethical behaviour, and crucially, can code compliance contribute to a reduction in corporate participation in corruption?

### **9.3 The case for improvement in the practice of corporate governance**

Compliance with the corporate governance code is not a legal requirement, merely its reporting, so there will always be a question about whether corporations that report high levels of compliance with the 2014 code are really governing in a manner consistent with international best practice. It is a reasonable claim from a point of view antithetical to both capitalism in general and corporations in Peru in particular that the people running those organisations will seek to conceal the truth about the persistence of legacy governance practices which would not be consistent with the code. The context for this point of view in Peru is also very understandable given its reliance on the extractive industries operating in remote locations. In rebuttal, I offer three considerations. First, the scope of the 2014 code is necessarily limited, and so cannot be expected to be a solution to all corporate misbehaviours, in particular, bribery is excluded, and therefore the persistence of such delinquencies does not necessarily detract from the effectiveness of the code itself. Second, the learning effect regarding new governance practices takes some time, so there will be a delay in aligning de facto practice with de jure statements - and there is evidence for such time delays in the case studies. Third is the effect of the exposure of corporate claims and behaviours to wider scrutiny, not only from the external institutional ecosystem, but also from corporations' own

employees - who, as I noted, are also Judgement Validators - so compliance with constitutive rules implies that corporations have fewer places to hide. I will expand on each of these points here.

As I noted in the discussion of the case of Graña y Montero, the governance code does not cover issues such as bribery which are now covered by a blend of hard law and additional codes of corporate practice (most notably ISO37001), nor does it cover the treatment of Indigenous rights when land is, in their view, misappropriated, and for which there are legal remedies. However, to the extent that the code catalyses the involvement of third parties in the corporation's decision making - crucially the INEDs - and makes sustainability more consistently a part of decision makers' thinking, there is at least now a group of designated outsiders with deontic rights and obligations, a supportive institutional ecosystem and more widely, a forum for public scrutiny of corporations' governance practice and a language with which to mount challenge.

There is also a distinct learning effect. This can take one of two forms. The first is for corporate leaders to think through what it means in practice to implement a new process or involve a new agent into a governance process. The respondents in the case study firms admitted that there was some delay in reaching their preferred level of compliance with the code because they wanted to get it right and not implement a new practice prematurely with the risk of collapse soon thereafter. Also, the surge in code compliance in the period 2014 to 2016 suggests that the incidence of corporate learning and/or preparation was widespread. The second, perhaps more crucial learning effect, is for corporate leaders to make the connections between the code's de jure principles and their de facto practice. A good example of this is the case of a corporation with high levels of compliance, but where the President was also majority owner in an insurance brokerage through which all the corporation's insurance passed ([Respondent 18/19](#)). This is not grand corruption but is clearly

a practice that would not pass thorough scrutiny by an alert board comprising several INEDs. Is this a case of *noblesse oblige* by a member of the elite who sees themselves as being above the rules which cover the ‘little people’? Or is it a deliberate and knowing oversight in the hope that the scam wouldn’t be discovered, or a real learning effect in which it takes corporate leaders some time to ‘join the dots’ and to realize that a legacy practice is no longer acceptable? My experience of high-compliance corporations in the case studies was that the level of scrutiny by INEDs, employees and others was sufficiently intense that a disparity between high compliance and good governance, at least for such firms, is unlikely to persist. I would also judge that some corporate leaders were certainly reflexive in their approach to governance and, some were also engaged in the stronger form of double loop reflexivity (Veldman et al 2016). This applies not only to those firms which had been involved in scandals such as COSAPI which has experienced external pressure to change their ways, but also for corporations such as Ferreycorp, which had elevated the improvement of their governance to a mission. To the extent that such reflexivity took place in some firms and resulted in double loop learning, it would be reasonable to conclude that actual improvements in governance practice would be the result. In other cases, firms’ reflexivity may have extended only to the discovery that the mere presentation of high levels of compliance might put them in favour of Judgement Validators and Evaluators in their respective fields.

However, the potentially profound innovation embedded in the code is the inclusion of constitutive rules which create new institutional facts, introduce new agents with new status functions into the governance process and, coupled with the sustainability movement create a wide and diverse set of agents able to sustain the new institutional facts through their collective intentionality. This plethora of third parties makes faking change more difficult to execute. This changing of the rules of the game is potentially the thin end of a wedge to prise open the dealings of corporations to greater transparency and scrutiny along with a language



to facilitate challenge where required. Assuming the process of refinement and reinforcement continues, it is very reasonable to assume that the standards of corporate governance will gradually improve for firms declaring high compliance with the code, because corporate leadership will find it increasingly difficult to maintain claims of compliance that do not accord with actual practice, so long as there is an active contingent of INEDs along with employees engaged in governance roles.

The third-party agents that have been granted new deontic rights and obligations include independent directors, board appraisers, auditors, minority shareholders, and employees. By far the most important of these innovations has been the introduction of INEDs onto corporate boards and board committees. Previously, boards had consisted of owner/proprietors with representatives on the board of the major shareholding identities. The introduction of individuals with no representational role specific to any individual shareholding but with deontic obligations to all shareholders represents a major shift in both the composition and the functioning of boards.

The additional requirement that board committees should be both staffed by and presided over by INEDs is revolutionary. The code contains the initial standard of three INEDs on the board. There are four practical issues with the inclusion of INEDs. The first is one of numbers: INEDs will in the main not have a majority vote on the board, and indeed may not even be able to fulfil the requirement to staff up all the board committees because they will be too few in number. A typical BVL board comprises seven to eight members, and so, if the average board size remains the same the INED contingent of three will be in a minority. In addition, with between five and eight board committees, it is difficult to see how these can be effectively maintained with any rigour by only three individuals.

The second issue is that of independence. As noted earlier, the original conception of independence embedded in the UK Combined Code was to be independent of management

because shareholders were assumed to be dispersed. However, control companies are the norm in most of the world and in Peru in particular. Independence from management is therefore insufficient as a criterion and if the INEDs are appointed by controlling shareholders who represent the bulk of the executive directors, it is difficult to imagine true independence of thought and action on serious matters, i.e., which would diverge from that of the controllers.

The third issue is that of accumulating adequate knowledge. It is common practice to refresh board appointments every three years, but if the entire contingent of INEDs is replaced every three years in a manner consistent with the written code, it is likely that the whole cohort will lack sufficient knowledge of the business to mount adequate challenge for at least a year. The research showed that corporations took different stances on this topic. For example, one public company changed its board regularly (perhaps too regularly) and attracted some criticism for the resulting dilution of aggregate experience. In contrast, private sector firms appeared to take a more nuanced approach to refreshing the board, either by staggering appointments or by retaining some long-serving, and therefore well-experienced directors.

The fourth issue is one of *over-boarding*. While there is a relatively small stock of potential INEDs, it is likely that a few individuals will hold several roles. This means that they will either not devote sufficient time to any given role or that they may lack the independence of thought and contribution required adequately to fulfil the role.

The regulator is very aware of the importance of INEDs and issued a much fuller definition of the role in 2019 than had been the case in 2014. Since 2016, the three leading universities in Peru, along with leading professional services firms and overseas partners, are engaged in providing training to directors, including INEDs, and have produced an estimated 400 alumni, though some of these will go on to serve the large family business market.

Nevertheless, much will depend on the personal abilities of the individuals concerned, and on how they negotiate the key flaw in the current arrangement – lack of independence and overall minority in numbers – to avoid being captured by controllers. On a positive note, a few corporations have opted for a majority of INEDs and of the case study firms in 2020, both COSAPI and Ferreycorp had an INED as President.

Despite the practical issues with INEDs, as a crucial constitutive aspect of the code, the accumulated effect of the developments described in this research are likely to be irreversible for firms exposed to the factors described in Chapters 5 to 8. For firms that are without such exposure but still required to report on their compliance with the code, it would seem unlikely that either their level of reported compliance or their de facto governance practice will alter materially.

#### **9.4 Coda**

In conclusion, the introduction of the 2014 governance code in Peru in 2014 has been an important initiative albeit one with limited scope. Despite the clear challenges that exist in such a context: the legacy of hierarchical capitalism; poor institutional development; issues of civil law; and the apparent unsuitability of such a code; a significant number of Peruvian corporations have shown willing to adopt best practice governance. While not achieving high levels of compliance throughout the listed sector, the code has been successful in establishing the basis for a new transparency in some corporations. For the corporations that now take compliance seriously, the initiative has momentum and is having an impact on real governance practice and, in conjunction with other measures, on corruption. For the firms that take code compliance less to heart, there is no reason to suppose that they are all either poorly managed or prone to corruption, those that are, will see little threat from an unenforced voluntary code. The number and diversity of organisations and individuals now engaged with the topic of corporate governance, especially since the repositioning of the

topic under the banner of sustainability, provide this new dispersed economic institution with a promising path dependency that is consistent with the original vision, to create a culture of good governance in Peru. Realistically though, given Peru's history of cycles of corruption interspersed by brief interludes of relative probity and given the limited scope of the code, the relatively small group of high compliance private and public listed corporations are likely to be looked upon as "islands of probity".

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### **Appendix 1: Evolution of the sustainability movement in corporate governance**

Since voluntary governance codes were introduced in 1992 societal attitudes towards the corporate impact on both society and the environment have become more demanding. This toughening is expressed in four interrelated initiatives: Corporate and Social Responsibility (CSR), Environment, Society, Governance (ESG), Socially Responsible Investment (SRI), and sustainability.

CSR<sup>239</sup> can be traced to two publications on the social expectations of placed upon corporations by the US Committee for Economic Development (CED 1970, 1971). which noted that the social contract between business and society was evolving in substantial and important ways so that business is being asked to assume broader responsibilities to society than ever before and to serve a wider range of human values (CED 1971:16). By the 1980's CSR was being operationalized as a complement to prevailing deregulation; as a decision-making process for businesses (Jones 1980) because it provided a framework for how businesses could engage with a range of stakeholders (Wood 1991); gave rise to the notion of stakeholder capitalism posited as a viable alternative to shareholder capitalism (Carroll 2008) and provided a framework for how globalizing corporations might engage with new value chains and new markets. Although CSR initiatives were initially seen as sources of additional cost to business, CSR initiatives became redefined as being of strategic value and sources of improved financial performance (Burke and Logson 1996).

Other developments followed: the notion of the *Triple Bottom Line* placed social and environmental dimensions of corporate performance on a par with financial performance

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<sup>238</sup> NB. The appendices are numbered with reference to the thesis chapter.

<sup>239</sup> For historic antecedents to the modern notion of CSR see Latapí, Jóhannsdóttir and Davídsdóttir 2019

(Elkington 1998); the United Nations Global Compact (UNGC) launched ten principles to guide corporate behaviour along with eight Millennium Development Goals (MDGs) related to societal goals such as human rights; the European Commission presented a green paper which led to a European approach to CSR understood to be: “*the responsibility of enterprises for their impacts on society and outlines what an enterprise should do to meet that responsibility*” (EC 2001: para 2); finally, the Committee on Consumer Policy of the International Organisation for Standardisation (ISO) began to align CSR guidelines with its quality and environmental management guidelines ISO9001 and ISO14001 and the new standard ISO2600 for Social Responsibility in 2010 that has since been taken up by 80 countries (ISO 2010).

ESG is a corporate performance measuring tool that extends CSR to include aspects of financial and governance performance which makes CSR of more direct relevance to institutional investors. The use of the term ESG can therefore be seen as an extension of the authors in the 1980s and 1990s who were seeking either to forge a relationship between CSR and financial performance or to extend the notion of CSR towards ‘strategic’ CSR or “value added” CSR. ESG has largely replaced CSR as the reference term in the corporate world, though there continues to be a flow of academic literature focussing on CSR.

Socially Responsible Investing (SRI) evolved by basing investment decisions not only on financial data but on an evaluation of firm performance against environmental, societal and governance criteria. The neoclassical economists were against restricting the investment universe (Markovitz 1952, Friedman 1970: 17, [McGeorge Bundy] Bailard 2018). However, during the late 1960s and 1970s a new type of investor emerged in the US catalysed by

reactions to the Vietnam War, inspired by progressive views on social issues<sup>240</sup> and observed the mantra: “*don’t invest in a company that conflicts with your values*” (Townsend 2020: 3).

In 1972, a fund was launched with the objective of investing in companies that “*show evidence in the conduct of their business, relative to other companies in the same industry or industries, of contributing to the enhancement of quality of life in America*” (Moskowitz 1973). By the 1980s, the SRI investment proposition was somewhat standardized based on a blend of avoidance strategies<sup>241</sup> and focusing on best in class. In 1990, the first index fund was launched which tracked the S&P 500 and established the methodologies and track record necessary to drive further growth of the SRI industry, later integrated with shareholder activism and an evaluation framework for corporations’ ESG performance. Further growth in the use of the SRI/ESG evaluation framework was catalysed by three factors: the United Nations Environmental Programme (UNEP) concluding that ESG could be an essential tool in predicting long term risks consistent with fiduciary duty (FBD 2005: 6); Litterman’s inclusion of climate change into an asset allocation model to inform investment decision through risk-based pricing (Blythe 2012); and the recognition that poor governance was potentially harmful to financial markets because of the damaging effects of corruption and market failure, especially in the capital markets which were key to the collapse of the sub-prime mortgage market in the US. In 2006, the United Nations published its Principles for Responsible investment (PRI) which by 2021 had been adopted by 4900 financial institutions<sup>242</sup>

Financial sustainability is assumed for a shareholder driven corporation because share valuations are based on determining the net present value of the free cash flow arising from

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<sup>240</sup> Nuclear energy, sweatshops, apartheid, GMOs, climate change, human trafficking the gender wage gap, tobacco, conflict mineral, state prisons.

<sup>241</sup> Avoiding investing in alcohol, tobacco, weapons, gambling, pornography, and nuclear energy

<sup>242</sup> Investopedia.com

<https://www.investopedia.com/terms/u/un-principles-responsible-investment-pri.asp>

ongoing business activities for the foreseeable future. The Brundtland Commission (UN 1987) defined sustainable development broadly as meeting the needs of current generations but not at the cost of the ability of later generations' ability to meet their own needs, and similarly it was expected that a balanced approach to doing business would lead to better profits (economic progress), better people (social progress) and a better planet (environmental progress) (Gupta 2020: 3). In 1995, the United Nations added impetus to the sustainability agenda by launching a series of annual conferences under the United Nations Framework Convention on Climate Change (UNFCCC) since known as the Conference of the Parties (COP)<sup>243</sup>. In 2000, the Global Reporting Initiative (GRI) was launched as an international independent standards organisation to provide a framework in which companies could publish a sustainability report on their CSR and ESG initiatives and is now used by 75% of the top 250 corporations. In 2015, the Paris Agreement and the 2030 Agenda for Sustainable Development published 17 sustainable development goals (SDGs), an extension of the UN's MDGs made more "action-oriented" and ratified by its 193 member countries, and now integrated into many corporations' sustainability reports. The UN's view of sustainable development is "*of a world in which economic prosperity prevails for all its members, with social inclusion of all the citizens, and environmental sustainability exists as a result of good governance*", one which includes all the three aspects of ESG which, in turn encapsulates the CSR and SRI agendas (Gupta 2020: 2).

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<sup>243</sup> The objectives of the COPs are to assess progress in dealing with climate change and to negotiate legally binding obligations for developed nations to reduce their greenhouse gasses. Thus far, three COPs have been held in Latin America: COP 4 in 1998 and COP 10 in 2004 in Argentina and COP 20 in 2014 in Peru.

## Appendix 3: Peruvian 2014 governance code and classification of rules

### Part 1 Peruvian 2014 governance code

No.	Ref.	Type	Pillars and detailed questions/implied rules
<b>I Shareholders' rights</b>			
	I.1	Regulative	Does the company recognize in its actions equal treatment to shareholders of the same class and who maintain the same conditions?
2	I.2	Regulative	Does the company only promote the existence of classes of shares with voting rights?
3	I.3	Constitutive	If the company has investment shares, does the company promote a voluntary redemption or exchange policy of investment shares for ordinary shares?
4	I.4a	Regulative	Does the company establish in its corporate documents the form of representation of the shares and the person responsible for registering the shares?
5	I.4b	Regulative	Is the registration of shares kept permanently updated?
6	I.5a	Constitutive	Does the company have a policy that the proposals of the Board of Directors referring to corporate operations that may affect the shareholders' right to non-dilution
7	I.5b	Constitutive	Does the company have a policy of making said reports available to shareholders?
8	I.6	Regulative	Does the company determine those responsible or means for shareholders to receive and require timely, reliable and truthful information?
9	I.7	Regulative	Does the company have mechanisms for shareholders to express their opinion on its development?
10	I.8a	Regulative	Is compliance with the dividend policy subject to evaluations at defined intervals?
11	I.8b	Con	Is the dividend policy made known to shareholders, among other means, through your corporate website?
12	I.9	Regulative	Does the company maintain policies or agreements not to adopt anti-absorption mechanisms?
13	I.10a	Constitutive	Does the bylaws of the company include an arbitration agreement that recognizes that any dispute between shareholders, or between shareholders and the Board of Directors, is subject to legal arbitration; as well as the challenge of resolutions of the AGM and the Board of Directors by the shareholders of the Company?
14	I.10b	Constitutive	Does said clause make it easier for an independent third party to resolve disputes, except in the case of express legal reserve before the ordinary justice system?
<b>II Conduct of the annual general meeting of shareholders</b>			
15	II.1	Constitutive	Is the approval of the remuneration policy for the Board of Directors an exclusive and non-delegable function of the AGM?
16	II.2	Constitutive	Does the company have a Regulation of the AGM, which is binding and non-compliance entails responsibility?
17	II.3	Constitutive	In addition to the convening mechanisms established by law, does the company have convening mechanisms that allow it to establish contact with the shareholders, particularly those who do not participate in the control or management of the company?
18	II.4	Constitutive	Does the company make available to the shareholders all the information related to the points contained in the agenda of the AGM and the proposals of the agreements that are proposed to be adopted (motions)?
19	II.5	Constitutive	Do the AGM Regulations include mechanisms that allow shareholders to exercise the right to formulate proposals for agenda items to be discussed at the AGM and the procedures to accept or reject such proposals?
20	II.6	Constitutive	Does the company have the mechanisms in place that allow the shareholder to vote remotely by secure, electronic or postal means, guaranteeing that the person who casts the vote is actually the shareholder?
21	II.7	Constitutive	Does the company have corporate documents that clearly specify that shareholders can vote separately on matters that are substantially independent, so that they can exercise their voting preferences separately?
22	II.8	Constitutive	Does the company allow those acting on behalf of several shareholders to cast differentiated votes for each shareholder, so that they comply with the instructions of each represented party?
23	II.9	Regulative	Does the company's Bylaws allow its shareholders to delegate their vote in favor of any person?



24	II.10a	Regulative	Does the company have procedures detailing the conditions, means and formalities to comply with in voting delegation situations?
25	II.10b	Constitutive	Does the company make available to the shareholders a model letter of representation, which includes the data of the representatives, the issues for which the shareholder delegates his vote, and if applicable, the meaning of his vote for each one of the proposals?
26	II.11a	Constitutive	Does the company have as a policy to establish limitations on the percentage of delegation of votes in favor of the members of the Board of Directors or Senior Management?
27	II.11b	Constitutive	In cases of delegation of votes in favor of members of the Board of Directors or Senior Management, does the company have a policy that the shareholders who delegate their votes clearly establish their meaning?
28	II.12a	Regulative	Does the company monitor the agreements adopted by the AGM?
29	II.12b	Constitutive	Does the company issue periodic reports to the Board of Directors and are they made available to the shareholders?
<b>III Board composition and function</b>			
30	III.1	Regulative	Is the Board of Directors made up of people with different specialties and skills, with prestige, ethics, economic independence, sufficient availability and other relevant qualities for the company, so that there is a plurality of approaches and opinions?
31	III.2	Constitutive	Does the company avoid the appointment of substitute or alternate Directors, especially for reasons of quorum?
32	III.3	Regulative	Does the company disclose the names of the Directors, their status as independent and their resumes?
33	III.4a	Regulative	Does the Board of Directors have the following functions: a. Approve and direct the corporate strategy of the company.
34	III.4b	Regulative	Establish objectives, goals and action plans including annual budgets and business plans.
35	III.4c	Regulative	Control and supervise the management and be in charge of the government and administration of the company.
36	III.4d	Regulative	Supervise good corporate governance practices and establish the necessary policies and measures for their best application.
37	III.5a	Regulative	Do the members of the Board of Directors have the right to: a. Request the support or contribution of experts from the Board of Directors.
38	III.5b	Regulative	Participate in induction programs on their powers and responsibilities and to be informed in a timely manner about the organisational structure of the company.
39	III.5c	Regulative	Receive remuneration for the work carried out, which combines recognition of professional experience and dedication to society with rationality criteria.
40	III.6	Constitutive	Does the company have Board Regulations that are binding and non-compliance entails liability?
41	III.7	Constitutive	Is at least one third of the Board of Directors made up of Independent Directors?
42	III.8a	Constitutive	Does the Board declare that the candidate it proposes is independent based on its inquiries and the candidate's statement?
43	III.8b	Constitutive	Do candidates for Independent Directors declare their status as independent before the company, its shareholders and directors?
44	III.9	Regulative	III.9. Does the Board of Directors have a work plan that contributes to the efficiency of its functions?
45	III.10	Regulative	Does the company provide its Directors with the necessary channels and procedures so that they can participate effectively in Board meetings, even remotely?
46	III.11a	Constitutive	Does the Board of Directors evaluate, at least once a year, objectively, its performance as a collegiate body and that of its members?
47	III.11b	Constitutive	Is the self-assessment methodology alternated with the assessment carried out by external advisors?
48	III.12a	Constitutive	Does the company's Board of Directors form special committees that focus on the analysis of those aspects that are most relevant to the company's performance?
49	III.12b	Constitutive	Does the Board of Directors approve the regulations that govern each of the special committees that it constitutes?
50	III.12c	Constitutive	Are the special committees chaired by Independent Directors?
51	III.12d	Constitutive	Do the special committees have an assigned budget?
52	III.13	Constitutive	Does the company have an Appointments and Remuneration Committee that is responsible for nominating candidates for Board member, who are proposed to the AGM by the Board, as well as approving the remuneration and incentive system of the company? Senior Management?
53	III.14	Constitutive	Does the company have an Audit Committee that supervises the effectiveness and suitability of the internal and external control system of the company, the work of the

			audit company or the independent auditor, as well as compliance with the rules of legal and professional independence?
54	III.15	Regulative	Does the company adopt measures to prevent, detect, manage and disclose conflicts of interest that may arise?
55	III.16a	Regulative	Does the company have a Code of Ethics (*) whose compliance is required of its Directors, managers, officers and other collaborators (**) of the company, which includes ethical criteria and professional responsibility, including the handling of potential cases of conflicts of interest?
56	III.16b	Constitutive	Does the Board of Directors or the General Management approve training programs for compliance with the Code of Ethics?
57	III.17a	Regulative	Does the company have mechanisms that allow complaints to be made corresponding to any illegal or unethical behavior, guaranteeing the confidentiality of the complainant?
58	III.17b	Constitutive	Are complaints presented directly to the Audit Committee when they are related to accounting aspects or when the General Management or the Financial Management are involved?
59	III.18a	Regulative	Is the Board of Directors responsible for monitoring and controlling possible conflicts of interest that arise in the Board of Directors?
60	III.18b	Constitutive	If the company is not a financial institution, does it have an established policy that the members of the Board of Directors are prohibited from receiving loans from the company or from any company in its economic group, unless they have the prior authorisation of the Board of Directors?
61	III.18c	Constitutive	If the company is not a financial institution, does it have an established policy that members of Senior Management are prohibited from receiving loans from the company or from any company in its economic group, unless they have prior authorisation from the Board of Directors?
62	III.19a	Constitutive	Does the Board of Directors have policies and procedures for the valuation, approval and disclosure of certain operations between the company and related parties, as well as to know the direct or indirect commercial or personal relationships that the Directors maintain among themselves, with the company, with your suppliers or customers, and other stakeholders?
63	III.19b	Regulative	In the case of operations of special relevance or complexity, is the intervention of independent external advisors contemplated for their assessment?
64	III.20a	Regulative	Does the company have a clear policy of delimitation of functions between the administration or government exercised by the Board of Directors, the ordinary management in charge of Senior Management and the leadership of the General Manager?
65	III.20b	Regulative	Do the appointments of General Manager and Chairman of the Board of Directors of the company fall on different people?
66	III.20c	Regulative	Does Senior Management have sufficient autonomy to carry out assigned functions, within the framework of policies and guidelines defined by the Board of Directors, and under its control?
67	III.20d	Regulative	Is the General Management responsible for complying with and enforcing the policy for delivering information to the Board of Directors and its Directors?
68	III.20e	Regulative	Does the Board annually evaluate the performance of the General Management based on well-defined standards?
69	III.20f	Regulative	Does the remuneration of Senior Management have a fixed and a variable component, which take into consideration the results of the company, based on a prudent and responsible assumption of risks, and the fulfilment of the goals outlined in the respective plans?
<b>IV Risk management</b>			
70	IV.1a	Regulative	Does the Board of Directors approve a comprehensive risk management policy according to its size and complexity, promoting a culture of risk management within the company, from the Board of Directors and Senior Management to the employees themselves?
71	IV.1b	Constitutive	Does the comprehensive risk management policy reach all the companies that make up the group and allow a global vision of critical risks?
72	IV.2a	Regulative	Does the General Management manage the risks to which the company is exposed and inform the Board of Directors of them?
73	IV.2b	Regulative	Is the General Management responsible for the risk management system, if there is no Risk Committee or Risk Management?
74	IV.3	Constitutive	Does the company have an internal and external control system, the effectiveness and suitability of which is supervised by the Company's Board of Directors?
75	IV.4a	Regulative	Does the internal auditor carry out auditing tasks exclusively, have autonomy, experience and specialisation in the issues under evaluation, and independence for monitoring and evaluating the effectiveness of the risk management system?

76	IV.4b	Reg	Are the functions of the internal auditor the permanent evaluation that all the financial information generated or registered by the company is valid and reliable, as well as verifying the effectiveness of regulatory compliance?
77	IV.4c	Constitutive	Does the internal auditor report directly to the Audit Committee on its plans, budget, activities, progress, results obtained, and actions taken?
78	IV.5	Constitutive	Does the appointment and dismissal of the Internal Auditor correspond to the Board of Directors at the proposal of the Audit Committee?
79	IV.6	Regulative	Does the AGM, at the proposal of the Board of Directors, appoint the audit firm or the independent auditor, who maintain a clear independence from the company?
80	IV.7a	Constitutive	Does the company maintain a renewal policy for its independent auditor or audit firm?
81	IV.7b	Constitutive	If said policy establishes longer terms for renewal of the audit firm, does the audit firm's work team rotate at most every five (5) years?
82	IV.8	Regulative	In the case of economic groups, is the external auditor the same for the entire group, including the off-shore subsidiaries?
<b>V Transparency</b>			
83	V.1	Regulative	Does the company have an information policy for shareholders, investors, other interest groups and the market in general, with which it defines in a formal, orderly and comprehensive manner the guidelines, standards and criteria that will be applied in the management, compilation, elaboration, classification, organisation and/or distribution of the information that society generates or receives?
84	V.2a	Constitutive	Does the company have an investor relations office?
85	V.2b	Constitutive	If there are caveats in the report by the external auditor, have these caveats been explained and/or justified to the shareholders?
86	V.3	Regulative	Does the company reveal the ownership structure, considering the different classes of shares and, if applicable, the joint participation of a certain economic group?
87	V.4	Constitutive	Does the company report on agreements or pacts between shareholders?
88	V.5	Constitutive	Does the company disclose the standards adopted in matters of corporate governance in an annual report, the content of which is the responsibility of the Board of Directors, following a report from the Audit Committee, the Corporate Governance Committee, or an external consultant, if applicable? the case?

## **Part 2 Classification of code rules into types (column 3 in the table above)**

The theoretical review of rule types and the role they play in the formation of institutional facts concluded that there were two important types of rules; the summary or regulative rule which the activity involving certain agents pre-date the rule, and the rule is used to make judgements or to direct treatment of future activities of the type in question. In the case of the practice or constitutive rule, the rule pre-dates the practice or institutional fact in question and the rule defines the institutional fact or the activity and the actors involved.

### **Application to corporate governance**

The Peruvian code contains 88 rules and close scrutiny reveals that these may be divided into two categories following Searle's definition of regulative and constitutive rules. Here, the constitutive rules have the characteristic that they bestow new deontic powers to agents. In this sense they are not like the rules of chess in defining ie inventing a new activity, but they

are transforming an existing activity by reconstituting it with new players. Typically, these constitutive rules seek to involve third parties in governance either for the first time or to provide them with transformed deontic powers and also to confer on existing directorates new deontic obligations.

I have applied this typology to the 2014 governance code using the following methodology:

Identify all the third parties that might be engaged with the firm in new ways. These were:

- Minority shareholders
- INEDs
- Auditors
- Board evaluators
- Board responsibilities
- Third parties to transactions

For each component of the code, evaluate whether the implied rule called for a *material* change in the engagement or deontic duties or obligations of the group in question. In the affirmative case, this was taken to indicate a Constitutive rule and in the negative case, a regulative rule.

Examples of Constitutive rules include:

- III.7. Is at least one third of the Board of Directors made up of Independent Directors?
- III.8.a. Does the Board declare that the candidate it proposes is independent based on its inquiries and the candidate's statement?
- III.11.b. Is the self-assessment methodology alternated with the assessment carried out by external advisors?
- III.12.c. Are the special committees chaired by Independent Directors?

Examples of Regulative rules include:

- I.8.a. Is compliance with the dividend policy subject to evaluations at defined intervals?

- II.1. Is the approval of the remuneration policy for the Board of Directors an exclusive and non-delegable function of the AGM?
- II. 9. Does the company's Bylaws allow its shareholders to delegate their vote in favor of any person?
- III.4.b. Does the Board of Directors establish objectives, goals and action plans including annual budgets and business plans.

Clearly this is an exercise in judgement about materiality of impact: in some cases, the inclusion of new people in the governance process such as INEDs is very clearly constitutive but the provision of better information to parties already engaged may be judged less material, and so there may be some questions where a case could be made for a change in category.

## **Appendix 4: Ethics and risk management**

### **1 Introduction**

The qualitative research module raises potential concerns both about ethics and risks either to respondents or to the interviewer. In this project, all the interviewees were senior professionals in their own fields: either shareholder, directors, non-executive directors or senior employees of major corporations, or directors or senior managers of regulatory agencies professional services firms or regulators.

### **2 Balance of power**

It is important to note that there was no imbalance of power between researcher and informants; I assumed that all informants were able to carry out their professional duties and have been chosen as informants to provide their professional opinion on the issues identified, and so on all occasions were responding within their professional capabilities. I also did not intend use any covert methods or deception except insofar as I structured the interview process in line with good market research practice, that is to start with open ended questions before soliciting specific responses and not disclosing my underlying hypotheses until very late in the interview when I am sure I have fully explored the informants' own and unprompted perspectives on the process of decision-making.

### **3 Ethical issues**

Several potential ethical issues were identified at the outset of the project which are all concerned with the project findings and their possible misuse.

*Issue: Breach of confidentiality - There may be an interest on the part of informants in learning what other informants have said.*

Mitigation: No respondents enquired about comments made by others. I stated the objectives of the study which are to obtain their professional opinion on the matters identified and was

clear to point out that their responses will be treated confidentially as will those of all respondents.

*Issue: Conflicts of interest - It is conceivable that an informant might be indiscreet and mention commercially sensitive information that I could act upon to my advantage.*

Mitigation: I minimized this eventuality by guiding the conversation to address the issues identified. In any case, I am unfamiliar with the Peruvian business scene and so am very unlikely to be able to derive advantage and since I have retired with sufficient personal funds, I have no interest in extraneous commercial entanglements.

*Issue: Discovery It is conceivable that during a conversation on corporate governance that an informant mentions immoral or illegal practices which puts me in the position of deciding how to treat that new insight.*

Mitigation: I maintained a focus on the discussion guide and the topics in hand and no such disclosures were made.

#### **4 Risks and mitigations**

##### **Potential risks for informants.**

*Risk: personal data may be leaked or come into the wrong hands.*

Mitigation: I collected no content-specific personal data collected other than professional identifiers such as the name, professional role and contact details of the interviewee. The bulk of this data was available on social media since this was the main recruiting tool. The personal data was only used to support the veracity of case study evidence intended to assist in distinguishing between theoretically derived hypotheses and to ensure that citations are used appropriately. The personal data was stored on UCL servers separately from the pseudonymised content/findings in the form of participants views and will be destroyed after the end of the project.

*Risk: individual informants may be vilified for the views that they express.*

Mitigation: Respondents did not express any views for which they might be vilified; even so, I obtained permission to use findings but, in any case, have not attributed findings to any individual by name. There are no plans for publishing this document, but the findings may be used in subsequent academic research by the author.

## **5 Potential risks to the interviewer which did not materialize.**

*Risk: the 'public' risks including exposure to strains of Covid for which I am not vaccinated, or the practical risks arising from being a stranger in locations where mugging may be likely.*

Mitigation: I conducted all interviews over Zoom and so was not exposed to any physical risks.

*Risk: there may be risks associated with possible exposure to sensitive information. This concerns any discrepancies between reported compliance and actual non-compliant behaviour involving dubious, illicit, or corrupt activities where engagement or the perception of engagement in an examination of such issues may present a risk to the interviewer.*

Mitigation: I was scrupulous in describing the objectives and scope of the project to all informants and no situations arose where the respondents breached the scope conditions of the interview.



## Appendix 5: Predicting individual firm compliance behaviour

To further reinforce the strength of the association between factors and firm compliance, I used the model developed in the linear regression to predict the compliance behaviours of firms with regard to individual rules. Since firm compliance behaviour is expressed in a binary manner – it either complies or not with any rule – I have used a logistic regression which can predict binary outcomes for a selection of high impact constitutive rules. In the first instance, I have used the same independent variables as in § 5 and allowed interactions.

### Results

For each constitutive rule in turn, the key metric is the degree of accuracy in predicting positive cases from the population of firms compared with the level of compliance for a particular rule in practice. I show in the table an evaluation of the predicted compliance outcome with actual compliance in 2020 with 11 constitutive rules for a population of 155 firms that reported in every year from 2014 to 2020.

Constitutional Rule	Compliance (%)	Predicted Compliance (%)	Proportion of Compliance Predicted (%)	Proportion predicted/Compliance
52. nomrem_com	22.6	21.31	94.3	4.17
46. int_review	43.2	40.61	94	2.18
40. dist_vote	38.7	32.24	83.3	2.15
41. ined	46.5	34.88	75	1.61
19. agm_prop	41.3	30.98	75	1.82
84. ir_dept	29	21.26	73.3	2.53
85. sh_acc	26.5	19.40	73.2	2.76
50. ined_chair	25.8	18.06	70	2.71
47. tp_review	15.5	10.34	66.7	4.30
16. agm_rules	39.4	18.72	47.5	1.21
40. mgnt_rules	58.1	24.52	42.2	0.73

The first two columns show the actual and predicted levels of compliance amongst the population of firms. The proportion of firms' compliance behaviour in column 3 accurately predicted is high - typically above 70%. Even where the predicted proportion is lower, for 10 of the 11 rules, the model always predicts a proportion of positive compliance cases that is above what would have resulted from a random selection. To illustrate with two rules: rule 41, the requirement to have INEDs comprising at least one third of the board was complied with by 46.5% of firms. The model successfully predicted 75% of these firms, a multiple over random selection of 1.6; and rule 50, the staffing of board committee chairs with INEDs was complied with by 25.8% of firms, 70% of which were predicted – a multiple of 2.7 over random selection. I also explored an overall measure of firm compliance with the 11 rules shown – firms with above the average compliance with the 11 rules. The model predicted 96% of the firms with above average compliance, a figure that was significantly greater than the 50% of firms with above average compliance.

## Appendix 6.1: Anonymised list of interviewees 2019 -2022

<b>2021 – 2022: Interviews conducted for doctoral research over Zoom due to covid restrictions</b>			
<b>Ref</b>	<b>Date</b>	<b>Role</b>	<b>Institution</b>
1	30/07/2021	Independent Non-Executive Director	Case study corporation
2	04/08/2021	Head of Corporate Affairs	Case study corporation
3	05/08/2021	Chief Financial Officer	Case study corporation
4	05/08/2021	Head of Investor Relations	Case study corporation
5	27/09/2021	Advisor	Professional association
6	16/09/2021	General Manager	State agency to promote shareholding
7	14/09/2021	Head of Legal	Stock Exchange
8	27/09/2021	Partner – Corporate Governance	Accountancy practice and governance consultancy
9	13/10/2021	Head of Legal	Corporation and institutional i
10	25/09/2021	Director	Business School
11	24/09/2021	Senior Manager	International financial institution
12	30/09/2021	Head of Governance	Case study corporation
13	27/10/2021	Ex Executive Chair and Major Shareholder	Case study corporation
14	09/11/2021	Deputy Chief Executive	Case study corporation
15	29/10/2021	Director: Department of Governance	Peruvian University
16	09/11/2021	Head of New Governance Index	Stock exchange
17	11/11/2021	Vice President	Case study corporation
18	03/11/2021	Partner	Advisory firm
19	03/11/2021	Head of Legal and Company Secretary	Case study corporation
20	16/11/2021	Head of Governance	Case study corporation
21	23/11/2021	Head of Governance	Case study corporation
22	09/12/2021	Independent Non-Executive Director	Case study corporation
23	24/11/2021	Head of O Legal	Case study corporation
24	22/11/2021	Coordinator of Sustainability	Case study corporation
25	25/11/2021	Head of Risk	Corporation and institutional investor
26	29/11/2021	Senior Manager	Accounting practice and consultancy
27	02/12/2021	Chief Financial Officer	Case study corporation
28	02/12/2021	Director	Sustainability agency
29	15/12/2021	Director	Responsible investing agency
30	14/12/2021	Head of Legal	Case study corporation
31	29/12/2021	Head of Sustainability	Case study corporation

32	11/03/2022	Head of Legal and of Governance Reporting	Case study corporation
33	17/03/2022	Head of Legal	Case study corporation
34	22/03/2022	Partner and Director	Accounting practice, consultancy and State agency
35	23/03/2022	Partner	Governance consultancy and recruitment agency
36	25/03/2022	Chief Executive	Integrity in business agency
37	01/04/2022	H O Sustainability	Case study corporation
38	01/04/2022	Independent Non-Executive Director	Case study corporation
39	08/04/2022	Independent Non-Executive Director	Leading mining corporation
40	10/05/2022	Director Ministry of Economics and Finance	Case study corporation
41	01/08/2022	Partner	Professional services and head-hunter
<b>2019: Interviews conducted for master's research face-to-face in Lima</b>			
<b>Ref</b>	<b>Date</b>	<b>Role</b>	<b>Institution</b>
-	April 2019	Ambassador	Peruvian Ambassador to London
1/19	London	Director	Peruvian UK trade arm
2/19		Director	Regional leader, NGO in mining sector
3/19		April 2019	Professor
4/19	6 <sup>th</sup> – 17 <sup>th</sup> May Lima*	Partner	Professional services firm
5/19		Partner	Professional services firm
6/19		Director	Stock Exchange
7/19		Director	Association promoting FDI
8/19		Dean and independent director	Peruvian University and Corporation in financial services
9/19		Director	Ministry Advisory group
10/19		Partner	Peruvian Business school lecturer/Lawyer
11/19		Professor in Economics	Peruvian University
12/19		Director	SBS: Regulator for banks, insurers, pensions
13/19		Senior Manager	SBS: Regulator for banks, insurers, pensions
14/19		Partner	White collar crime lawyer
15/19		Founder director	Private capital fund
16/19		Head of Legal	Institutional Investor
17/19		Independent Director	Multiple INED and private capital investor
18/19		Journalist	Leading business journal
19/19		Director	Stock exchange central registry

20/19		Head of Legal	Institutional Investor
21/19		Partner and Director	Professional services firm and Association promoting capital markets
22/19		Director	SMV: Regulator for BVL, brokers and firms
23/19		Senior manager	SMV: Regulator for BVL, brokers and firms
24/19		Senior manager	SMV: Regulator for BVL, brokers and firms
25/19		Multiple independent director	Stock exchange and Apex Industry association
26/19		Director	Apex industry association
27/19		Director	Ministry of Economics and Finance
28/19		Director and Head of Governance	Public sector holding company
29/19		Professor	Peruvian university
30/19		CEO & Independent Director	Leading mining corporation
31/19		Inhouse Lawyer	Corporation
32/19		Director	Professional Association
<b>*NB. All individual face-to face-interviews, 45 – 90 minutes, Lima 6<sup>th</sup> – 17<sup>th</sup> May 2019, except:</b>			
	1/19 – 3/19		London/Oxford
	4/19 and 5/19		Interviewed separately and together
	12/19 and 13/19, 23/19 and 24/19		Interviewed together
	22/19		Conversation in a conference

## **Appendix 6.2: Additional case studies**

This appendix contains five case studies that complement the three studies of Ferreycorp, Fondo Mivivienda and Sociedad Minera Corona in the body of the document. In appendix A6.2.1, I present the case of COSAPI, a major construction firm established in 1960 that in 2019 was judged to be the second largest engineering and construction group in Peru by sales volume. COSAPI illustrates the response of a firm for which reputation is of paramount importance when caught up in a public procurement scandal that was made public as a result of the Odebrecht affair and how the governance code became an important rubric for what became a new board. In A6.2.2, I discuss the case of Credicorp, a large diversified financial group which owns the largest bank in Peru. Corporate governance is crucial to the reputation of several of the group's subsidiaries in their respective markets, and the firm had been engaged in an extended project to modernise its governance. In A6.2.3 I present the case of Arco Continental Lindley (ACL), a leading producer and distributor of soft drinks in the region and Coca Cola's regional partner. ACL emerged following the acquisition of Corporación Lindley by Arco and illustrates the effect on governance and on code compliance of exposure to a major global branded supplier in the form of Coca Cola and to a foreign owner. In A6.2.4, I use the case of Compañía Minera Poderosa, a successful mining company still largely under private ownership with little exposure to external financial or stock markets and with little need to depend on the governance code for maintaining a tight group of relationships associated with its owners, the communities affected by its extractive activities and the markets it serves. In A6.2.5, I discuss the case of Graña y Montero, the now infamous corporation that served as Odebrecht's main partner in Peru and that bore the main brunt of the ensuing scandal of the Lava Jato disclosures. Graña y Montero is of interest because prior to its indictment, it had very high levels of code compliance despite the

ongoing engagement of a handful of senior people in bribery and corruption activities not covered by the governance code.

## A6.2.1 COSAPI      Illustrates post-scandal legitimacy seeking

### Background Information

COSAPI was established in 1960 by Walter Piazza Tangüis and José Valdez Calle. It is the second largest engineering and construction group in Peru by sales volume, according to the *América Economía* Ranking 2019, with 60 years of participation in many of the main infrastructure works in Peru and partnerships with leading global brands such as Bechtel and Shougang and Latin-American firms such as SADE and Laech. COSAPI's business model is characterized as a series of independent development and construction projects, often of renown, often with important partners and for well-known clients which are each individually financed. The firm is an internationally diversified group with a holding company and nine operating entities in three divisions across six countries.

A division of COSAPI was identified during the revelations accompanying the Odebrecht scandal as having paid bribes for the awarding of contracts for road construction in the period 2011 to 2014, along with 30 other constructors<sup>244</sup>. It was investigated by the Anti-Corruption Prosecutor's Office in 2017 and elected to collaborate with investigators. The firm was required to pay civil compensation of S55.6m and senior directors reigned. COSAPI appears to have repaired its reputation somewhat as indicated by its inclusion in more recent construction bids including the Metro de Lima Line 2. (COSAPI 2020). COSAPI illustrates the effect of a scandal on corporate culture and on governance in a family dominated business heavily dependent on its good name for winning a succession of large infrastructure contracts.

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<sup>244</sup> The '*Club de la Construcción*' was a cartel of over 30 construction companies including Odebrecht, Graña y Montero, Cosapi, ICCGSA, Málaga, OAS and Andrade Gutierrez and Camargo Correa which operated 112 projects between 2002 and 2016 by coordinating tenders and eventually fined 2.76 bn Soles (US\$690) by INDECOPI the state competition and consumer protection agency ([www.perusupportgroup.org.uk](http://www.perusupportgroup.org.uk))



## Highlighted Evidence

The highlighted evidence from the documentary and the testimonial research which have most information value regarding COSAPI's stance on governance. All references to COSAPI's annual accounts and SMV submissions can be found on their company website.<sup>245</sup> COSAPI had been operating much as a private company since its founding in 1960, its shares were held by just 43 shareholders and although the firm registered with the BVL, the shares are not traded on the exchange. Only seven shareholders have more than one percent and five over five percent. The top five shareholders are all Peruvian and comprise two funds and three individuals related to the founders:

**Table 1: Shareholding structure of COSAPI**

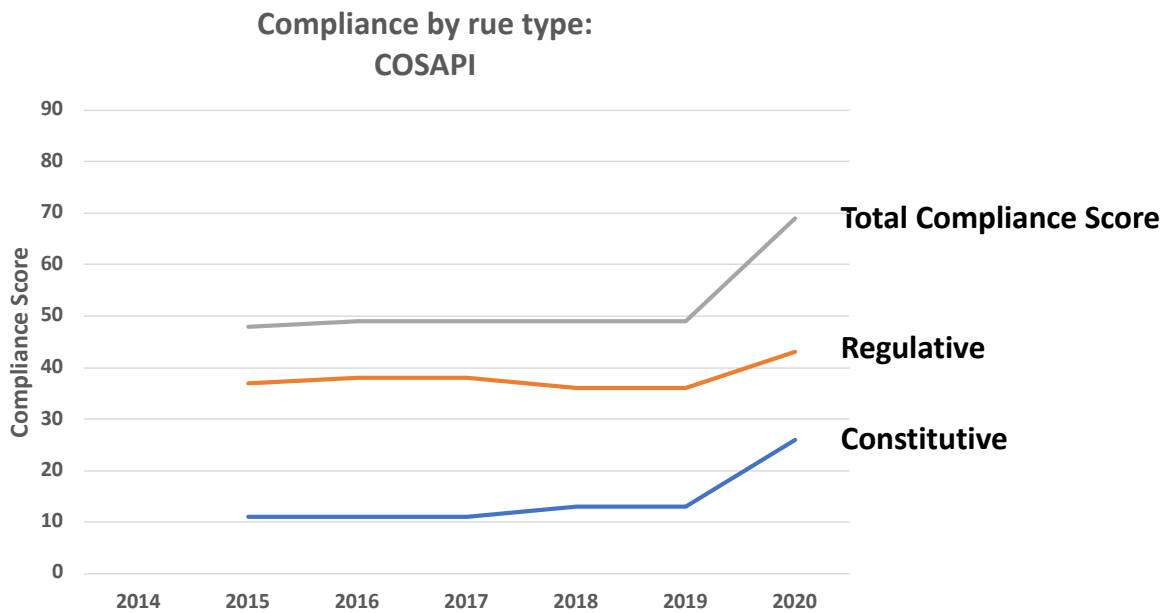
Shareholders		Percentage of capital
Funds	Interandes Holding	37.45
	Laech S.A.C.	25.00
Individuals	Walter G. Piazza de la Jara	12.62
	María Cecilia Gerarda Piazza de la Jara	11.16
	María Rosa Torero Musante	5.92
Sub Total		92.1
38 others		7.9
Total		100

There has been very little movement in the shareholders in the period 2014 to 2020. COSAPI's business model is that each project is funded with partners and the funding is hypothecated to each project. The firm therefore makes no recourse to the capital markets.

<sup>245</sup> <https://www.cosapi.com.pe/Site/Index.aspx?aID=1196> and for more recent reports <https://www.cosapi.com.pe/Site/Index.aspx?aID=1841>

COSAPI’s stance on the 2014 governance code had been to treat it as a relatively low priority until after 2019.

**Figure 1: COSAPI improved its compliance dramatically in 2020**



When it was revealed in 2017 that the director of a low margin subsidiary was participating in what had been assumed was the common practice of colluding with competitors, the senior management of COSAPI firm reacted quickly to take assertive action over the disclosure of the construction club, first externally to cooperate with the authorities.

*‘In 2015 COSAPI was the first company to approach Indecopi, the authority that regulates competition, and the Public Prosecutor's Office to say: Gentlemen, I have wrong. I am part of this club and I want to make amends.’ (Respondent 20)*

*‘... we accepted that we should pay some heavy fines which we are only just finishing now.’ (Respondent 13)*

*‘When it started it [the club] was normal practice and times have changed so now it is not. We stopped the business immediately and agreed to help with the investigation into what became known as the Construction Club.’ (Respondent 20)*

The firm also responded internally. Senior figures including family members and shareholders in the business accepted responsibility for the misdemeanours and resigned even though there had been no personal direct involvement.

*‘I used to be President, and before that it had been my father, but I stepped down as President last year [ie in 2020].’ (Respondent 13)*

The board composition changed dramatically between 2019 and 2020.

**Table 2: Board structure of COSAPI**

<b>Directors</b>	<b>2014-2017</b>	<b>2018-2019</b>	<b>2020-21</b>
Walter Piazza de la Jara**	Executive President	Executive President	-
Fernando Valdez Torero	VP	VP	-
Hermán Escalante Pareja	Director	Director	-
Francisco Moreyra Mujica (2007)	Director	-	Director
Alfredo Silau Valdez	Director	-	-
Felipe Barclay Piazza	Director	Director	-
Maria Helena Hernández Pastor*	Director	Director	-
Eduardo Torres-Llosa Villacorte			President & INED
Javier Amézaga Castañeda			VP
Enriqueta González Pinedo de Sáenz			INED
Francisco Jorge Paz Sáenz			Director
Leonardo Rischmoller Delgado			INED
Mario Marchese Mecklenburg			INED

NB \* Head of Accounting and representative of Interandes Holding SA

The board had had a stable board membership with long-serving directors including shareholders but with no INEDs until 2020. In 2020, the board completely changed with six new members and the calling back into service of a previous long-serving director. Four of

these seven were INEDs, ie a majority, including the President, who no longer took the role of CEO. This is a revolutionary change, but the board is arguably still in transition as a hybrid - since the original families still have direct representation on the board.

*‘We now take independence very seriously, for the first time in our history we have an independent board – we have seven directors and four of them including the President, are independent, they are completely independent professionals and three represent the majority shareholders: the Piazza family, the Valdez family and the Laech Fund.’ (Respondent 13)*

The firm also established four board committees in 2020.

**Table 3: COSAPI board committees and membership**

Committee members	New Board Committees 2020 and 2021			
	Ethics, Compliance and Governance	Audit	Nominations and Remuneration	2020 - Risk, in 2021 - Innovation, Process and Risk
<b>Independent Directors</b>				
Enriqueta González Pinedo	<b>President</b>	Member		
Eduardo Torres-Llosa Villacorte		<b>President</b>		Member
Leonardo Rischmoller Delgado			Member	<b>President</b>
Mario Marchese Mecklenburg		Member		
<b>Executive Directors</b>				
Francisco Jorge Paz Sáenz	Member		Member	
Javier Amézaga Castañeda	Member			Member
Francisco Moreyra Mujica			<b>President</b>	Member

INEDs preside over three committees, although not the important Nominations and Remuneration committee which is run by a long-standing director. COSAPI embraced the notion of independence quite deliberately.

*‘... we did this on purpose as a clear signal to give a message to the market – not because we were forced to but because it is the right thing to do. We also set up the board committees mostly staffed by independents, and we appointed a new general*

*manager and new heads of business development, operations and legal. Our challenge is to dismantle a bureaucratic organisation and set up completely new governance processes without creating a new bureaucracy.’ (Respondent 17)*

The Board began to take governance more seriously and, it would appear, in a matter-of-fact manner.

*‘COSAPI already had a code for corporate governance, but they didn’t look at it then or take it very seriously. But they started talking about compliance and in 2017 the CEO created a ‘compliance’ team, and it became very serious. When the new board was formed, we found we only complied 50% of the governance code. So we set up the main board committees and a compliance and ethics committee which I chaired as an independent, and these committees have the job of following up and improving our governance.’ (Respondent 20)*

Communications also changed. Typically, from 2014 to 2019, the annual report was short at 36 to 43 pages, with little mention of governance, ESG, CSR or sustainability and with no integrated Sustainability or Compliance reports. In 2019, there was the first section on governance, but little else. By 2021, the report had grown to 93 pages, had complete sections on governance, sustainability and environmental and social programmes and incorporated reports about sustainability and governance though still not the Sustainability and Compliance Reports themselves. The firm also changed its website: *‘The first thing was to make our information more transparent by publishing everything on our website – this includes the percentage of shareholders, the committee bylaws and the board membership and how it all works.’ (Respondent 20)*

Post the firm’s reaction to the disclosures, COSAPI claims to be *‘constantly analysing best practices and regulations of Corporate Governance at the national and international*

*level to evaluate and assess their application and incorporation into internal regulations.’*

(COSAPI 2020: 35)

The stated priority was to rebuild COSAPI’s reputation with clients, financiers and partners is crucial. Because of COSAPI’s business model in which each project is a fresh initiative, its reputation is key to securing ongoing work and third parties are seen as influencing the business. COSAPI itself is self-financing with an increase in capital in 2017 (COSAPI 2020). This is achieved by hypothecated funding for each project undertaken. External relationships are therefore essential.

*‘Our clients are the most important people to us and have most influence on how we run the company – we have a lot of very prestigious clients building landmark properties in Peru. For them, the building and the project are life changers and so have to be right.’ (Respondent 13)*

Environmental and social impact was also mentioned because of the long-term nature of COSAPI’s projects and relationships.

*‘Sustainability is very important to our business because if we get a reputation for polluting rivers clients would never hire us. For a company like us all the words about the environment have to be built into our working practices. Reputation and financial strength are crucial for us, a bit like a bank – trust is crucial - they don’t want to find out 10 years later that there is a problem in the ground.’ (Respondent 13)*

The firm is now ambitious regarding its new approach to governance and the code provides them with a target representing best practice:

*‘In fact, now we want to exceed the code wherever we can, and the code provides a lot of guidance for us on governance.’ (Respondent 17)*

Governance is also becoming integrated as far as possible into their business dealings. Where there are explicit performance targets

*'We have all the detail of the requirements built into contracts for each project. These will have performance bonds which could total 10% of the value of the project.*

*Clients are not so interested in the technical aspects of governance, but where we can we put these into the contract for a project.'* (Respondent 13)

COSAPI has sought to involve its whole supply chain in its new approach to governance.

*'Because it seems that it was a practice that engineers, managers, or juniors, also worked, had their own engineering companies that could use the same providers or provide training or services to COSAPI, so they have to be included also.'*

(Respondent 20)

In addition, there is a new caution over continued dealings with any State employees. COSAPI is now especially cautious in its dealings with the state and with public officials in general and has established new protocols for managing these relationships:

*'Our biggest client is the State and that is where any corruption can take place. We now have policies for interaction with public officials so no COSAPI official should go alone to a meeting with any public official. There must be at least two of us there.'*

(Respondent 20)

The new leadership, especially the incoming INEDS, are keen to distance themselves from the past. The new board members were very concerned to understand what had occurred with COSAPI in the past to separate themselves from any misdemeanours and appeared to have been very thorough in auditing the company for fear of their own personal liability.

*'...directors have personal responsibility for all the events that have occurred up to two years after their service, and even two years before. When we came to the board, we said we want a report, which they gave us from the lawyers Benites and Ugaz.'*

*There were meetings with the Attorney General's Office. Falla and Bullard also gave us a report of everything they had learned in Indecopi. ' (Respondent 20)*

Incoming INEDs also brought expertise in governance and compliance from other companies.

*'I worked at XXXX Peru, and I also had compliance in my charge, and governance and the chairman told me «I want you to oversee compliance» and corporate governance, and that you reinforce it and we will do independent audits.'*  
(Respondent 20)

And clearly plan to be active in investigating any irregularities:

*'We saw that this process was transparent, that there was a definitive break with the past, and we are aware that if we discover any hint, any small sign, that there is something that it is not correct, we survey, we do audits, and we investigate what happened.'* (Respondent 20)

There is a huge focus on individual responsibilities and actions about corruption and conflict. COSAPI have personalized their approach to compliance and ethical management throughout the business with training, personal commitments and feedback channels which are followed up.

*'All members of the board must make personal declaration of their interests annually and we need to empower the organisation, so we are very vocal internally about compliance issues. People must attend meetings to find out about compliance. We have a whistle blower mechanism (canal de denuncias) which is fed into the ethics committee and there is a disciplinary procedure which we review at the board. This process is used by employees.'* (Respondent 17)



Throughout this process, there has been no use of cost benefit appraisals for governance actions. COSAPI does not assess code compliance in terms of cost/benefit calculations.

*'For us it was an existential crisis, we just had to take action, so we are not concerned about the costs of governance, it is a small price to pay to be in business.'*

*(Respondent 13)*

*'I am not aware of the financial cost of compliance, it is not something we discuss because projects are so huge, governance has become a requirement of being in business.'* *(Respondent 20)*

In addition to managing its partners and supply chain, COSAPI is keen to seek certifications. Judgement validator certifications are important for COSAPI and are subject to what appears to be a realistic dialogue given proceedings. This is apparent in their keenness to deal with EplI as soon as the prosecutor allowed and to be seen to deal with corruption.

*'We were already the first company in Peru to have ISO 37 001. A few months ago, Empresarios por la Integridad asked us if we wanted to become certified and we said yes. We have the effective collaboration agreement already approved by the Prosecutor's Office pending approval by the judge.'* *(Respondent 20)*

### **Judgement on Weight of Evidence comparing pairs of hypotheses**

On the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence would seem to be very implausible in the world of the Efficiency hypothesis. Whether before but especially after the construction club disclosures, the firm's commitment to rebuilding its reputation, changing its top management, and improving its governance processes, speaks to a firm that is seeking to trim costs, and the FD explicitly denied taking a cost/benefit approach. Similarly, there is little in the evidence regarding the post 2019 period that would seem plausible in the World of the Power hypothesis. The firm has ceded most of

the board to INEDs under an INED President, and this is not to be expected where the original families wished to be clearly in control. It is true that there is a legacy of representative control in the form of the executive directors representing the majority shareholders, but this does not seem to be expressed in any way to deceive. Even pre disclosures in those parts of the business that were directly involved in the construction club, the tender fixing is described as a widely accepted practice to deal with a low margin business with a fickle client, and since then the firm has taken pains to cooperate with the authorities and to ‘do the right thing’. I therefore rate the Weight of Evidence to be favour of  $H_P$  over  $H_E$ <sup>246</sup> as 0dB to reflect the lack of any discernible difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, the bulk of the highlighted quantitative evidence, especially the direct dealings with the prosecutors’ office and other agencies, the complete change at the top and the overhaul of the governance process under an INED ex banker, its commitment to rebuilding its reputation with a disparate and changing group of business clients and partners, and rebuilding the trust of its workforce, especially at a time when Peruvian society was reeling from the Lava Jato disclosures, is evidence that is very much more likely to emerge in the world of the Legitimacy hypothesis than that of its rival. This is clear evidence of ‘double loop’ reflexivity, certainly during the immediate aftermath of the investigations, and it was still evident from the interviews that a new culture was emerging and being extended to their value chain. Regarding the Power hypothesis, the ruthlessness of the changes brought about does speak of power, but there is no guile here, the firm faced an existential crisis. I therefore rate the Weight of Evidence in favour of  $H_L$  over  $H_P$ <sup>247</sup> as +30Db to reflect the very strong difference between the likelihoods.

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<sup>246</sup> Denoted  $\log[P(E_C|H_E)/P(E_C|H_P)]$

<sup>247</sup> Denoted  $\log[P(E_C|H_L)/P(E_C|H_P)]$

**Table 2: The Weight of Evidence for COSAPI (2020) favours Legitimacy seeking**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(E <sub>Co</sub>  H <sub>E</sub> )	Quite Implausible	$\frac{P(E_{Co} H_E)}{P(E_{Co} H_P)}$	Indistinguishable	0	0	-
P(E <sub>Co</sub>  H <sub>P</sub> )	Quite Implausible					
<b>Legitimacy versus Power</b>						
P(E <sub>Co</sub>  H <sub>L</sub> )	Extremely Plausible	$\frac{P(E_{Co} H_L)}{P(E_{Co} H_P)}$	Strongly in favour of HL	-	0	30
P(E <sub>Co</sub>  H <sub>P</sub> )	Quite Implausible					
<b>Total Weight of Evidence from COSAPI</b>				<b>0</b>	<b>0</b>	<b>30</b>

\*NB. Note HP is used as the base case in each pairwise comparison

This conclusion is very strongly in favour of the Legitimacy hypothesis HL for COSAPI but is only relevant for the latter part of the period under question at which time the firm made major changes to its leadership, corporate governance and management practices and appears to have fully engaged its staff in the process. Prior to the disclosures, I suspect the conclusion may have been only very mildly in favour of the legitimacy hypothesis regarding the code, but in fact I was struck by the sense of irrelevance of the code to the business before disclosures; COSAPI had good relationships with its value chain, won contracts and prospered. The code was not apparently relevant to them to continue in this manner prior to 2020.

## **A6.2.2 Credicorp illustrates legitimacy-seeking (with reservations)**

### **Background Information**

Credicorp is the largest financial holding company in Peru with a portfolio of businesses covering universal banking, micro finance, insurance & pensions, and investment banking & wealth management. The firm was established as the Banco Italiano in 1889 and was renamed Banco de Credito del Peru in 1942. In 1995, Dionisio Romero Seminario and a group of investors established Credicorp as a holding company to acquire Banco de Credito del Peru (BCP), Atlantic Security Holding Corporation (ASHC) and Pacifico Compania de Seguros y Reaseguros S.A. (PPS). Credicorp is now mostly owned by funds but 13% is still owned by Grupo Romero, an extensive family-owned business group. The firm has seven principal operating subsidiaries in four operating divisions. Banco de Credito del Peru (BCP) represents approximately 75% of group revenues operating in retail and wholesale banking, is the market leader in universal banking and is the amongst the most valuable brands in Peru<sup>248</sup>. Grupo Pacifico Seguros is an insurance Company offering life assurance, P&C insurance and health insurance and is the number 2 provider ranked by total net earned premiums. Prima AFP, in second position of the four pension firms operating in Peru offering personal and corporate pensions, and savings vehicles, and is an active investor in Peru. Credicorp Capital and Atlantic Security Bank (ASB) offer corporate finance, capital markets operations, and asset & wealth management services to retail, corporate and institutional clients in the Americas. The firm is listed on the NYSE and has an operational presence in the USA, Panama, Peru, Colombia, and Chile. In 2019, Credicorp's then Chairman Dionisio Romero testified before the prosecutor that he had contributed \$3.65m to fund the presidential campaign of Keiko Fujimori between November 2010 and May 2011 in 17 cash tranches. He also noted that Credicorp also contributed of the order of \$650,000 to

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<sup>248</sup> <https://www.statista.com/statistics/274388/most-valuable-peruvian-brands/>

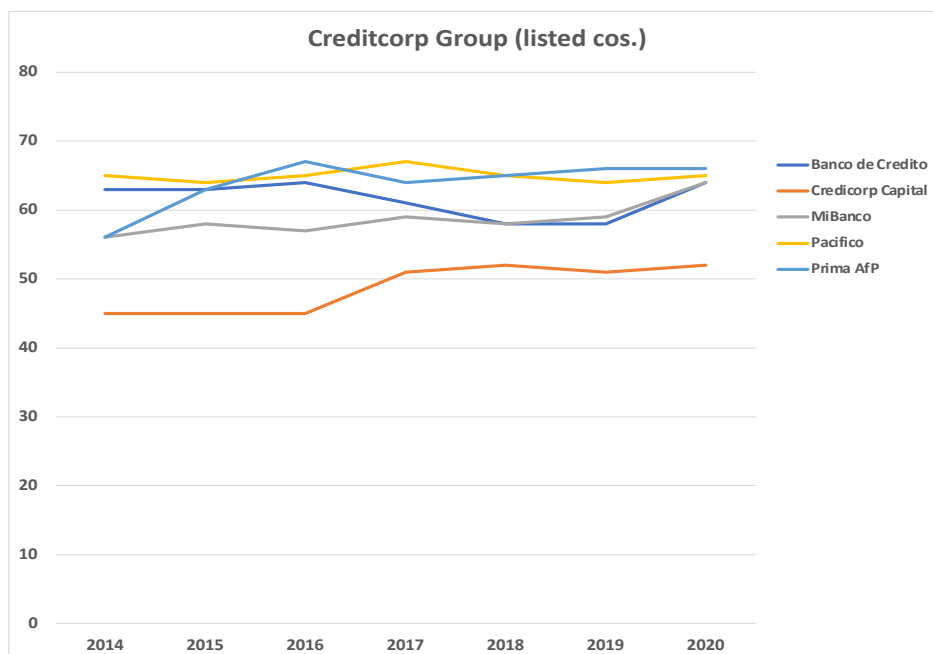
the campaigns of Peruanos por el Kambio led by Pedro Pablo Kuczynski and of Fuerza Popular led by Keiko Fujimori.

### Highlighted Evidence

Interviews were carried out in October 2021 with four individuals within Credicorp: the deputy CEO and leader of a transformational project on governance, an INED and board committee chairman of BCP, the Head of Legal for PRIMA AFP and the Head of Legal for BCP. In addition, reference is made to several annual accounts all of which are available online<sup>249</sup>.

Credicorp has five listed firms in its group, each of which submits its own returns to the SMV and the SBS with a generally consistent record of slowly improving compliance across the group. However, the capital markets business Credicorp Capital has a consistently lower level of compliance than the retail facing businesses.

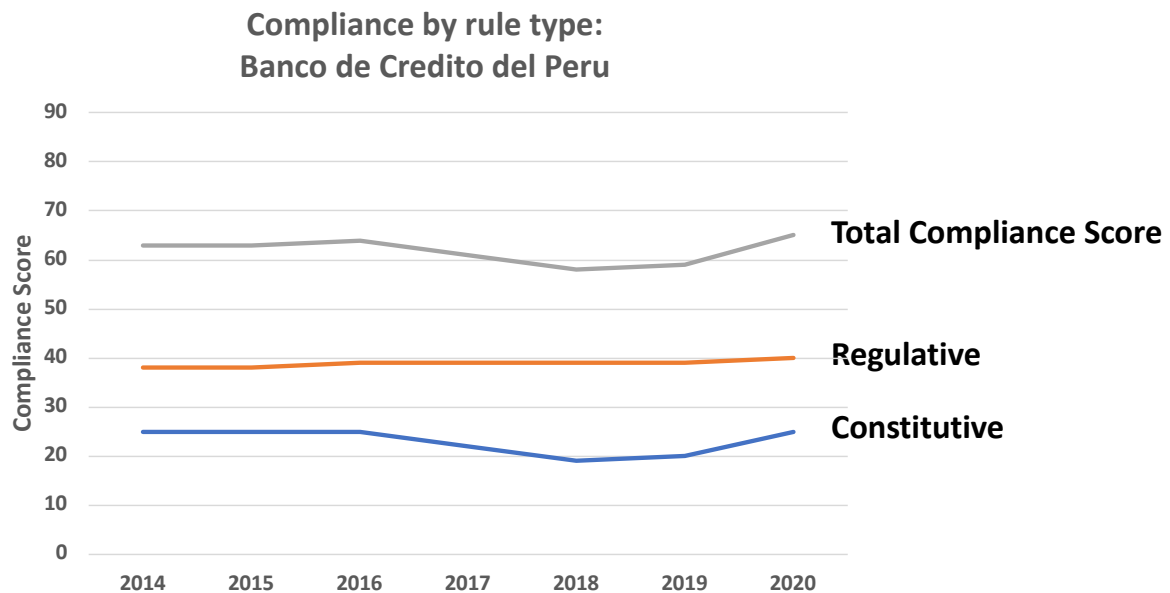
**Figure 1: Credicorp group company compliance**



<sup>249</sup> <https://credicorp.gcs-web.com/annual-reports-english>

Banco de Credito del Peru, the dominant subsidiary with two thirds of the balance sheet footings of the group, has maintained a high regulative compliance with the code but lagged on constitutive compliance throughout the period 2014 to 2020.

**Figure 2: Banco de Credito, compliance by rule type**



The Fujimori scandal was seen internally to have damaged the bank’s reputation but appears to have been used as an impetus to further the transformation of its governance.

*‘It really dealt a very, very strong blow to the reputation of Credicorp, and to the entire Credicorp group of companies. Even though it happened in 2011 and what was done was allowed by law, it has forced us to clean up the company.’ (Respondent 14)*

*‘There has been a huge change: everyone is new, so it is no longer a representation of the main shareholders or even external type of board members that had been very involved with Credicorp before. We have a lot of independent directors, women and several that come from other countries and from other businesses.’ (Respondent 22)*

There is internally a confidence that a repeat performance of the Fujimori funding will be unlikely:

*'It is very difficult to control such a situation unless you are going to have spies. But I think there was a lot of learning from what happened in that incident, so everybody is much more aware. I think that should help not only the chairman but also the rest of the board members to make sure that you don't do anything like that again.'*

(Respondent 22).

Despite the obvious connection to the scandal, Credicorp claim there was already a long-term project to redesign governance processes in a ten-year project to build a sound governance process which sets sustainability at its core – Its primary business objective is stated as being *“To be a sustainable financial services leader in Latin America.”* (Credicorp 2020: 140). The firm is promoting ESG throughout the business and sustainability is a clear priority:

*'We used only to talk about sustainability but now it has been put in a prominent place and, we provide training on sustainability to directors and the new Sustainability Committee of Credicorp gets more weight to ensure sustainability in all the activities of the company.'* (Respondent 30)

The language of ESG is prevalent in the business.

*'The Sustainability Committee is focussed on the 'S' part of ESG. In a country like Peru this is important to address financial inclusion and innovation. We are having roadshows so we can talk with people outside and so the 'E' part of ESG is also important, for us in terms of who we offer credit to. The 'G' is the base but the other two are crucial and if I had to choose, I would favour the 'S'.'* (Respondent 22)

Credicorp executives assert that sustainability is also concerned with client behaviours and what activities the firm is supporting in its business dealings, through its client selection for lending:

*'the compliance area makes sure that those to whom the bank lends funds are a serious company that really complies with the laws, and not only on paper, but that it truly complies and it is really saying what it is and not lying to us.'* (Respondent 30)

Respondents note that the firm's innovation in products contributes to sustainability, for example, as the Yape payment service which makes online payments available to an otherwise unbanked demographic.

*'There is a huge part of the population that is outside the system – with our electronic wallet Yape they can get transfers from the government which they couldn't get before without a bank account.'* (Respondent 22).

Despite these claims, the group board has been slow to migrate some of its processes to accord with the governance code. It only recently moved to having a majority independent membership in 2019/2020 when it shifted rapidly from a long-serving board of mostly full directors to a short-serving board of mostly independents (Table 6.13).

**Table 1: The Credicorp board only changed materially in 2020**

Director	Year					Years Served
	2014 to 2016	2017	2018	2019	2020	
Dionisio Romero Paoletti	Reapp. President & CEO	Reapp. President & CEO	Reapp. President & CEO	Reapp. President & CEO	To June 20	18
Raimundo Morales Dasso INED	Reapp VP since '08	Reapp VP	Reapp VP	Reapp VP	Reapp VP	14
Fernando Forte Marie	Reapp.	Reapp.	Reapp.	Reapp.	Reapp.	40
Juan Carlos Verme Giannoni INED	Reapp.	Reapp.	Reapp.	Reapp.	To June 20	31
Benedicto Ciguenas INED	Reapp.	Reapp.	Reapp.	Reapp.	To June 20	17
Martín Perez Monteverde	Reapp.	Reapp.	Reapp.	Reapp.	To June 20	8
Reynaldo Llosa Barber Benavides	Reapp.	to March 17	-	-	-	35
Yarur Rey	Reapp.	to March 17	-	-	-	23
Luis Romero Belismelis		From April 17	Reapp.	Reapp.	Reapp. President	3



Patricia Lizárraga INED		From April 17	Reapp.	Reapp.	Reapp	3
Alexandre Gouvea INED					From July 20	1
Irzio Pinasco Menchelli INED					From July 20	1
Antonio Abruña Puyol INED					From July 20	1
Maite Aranzabel Harreguy INED					From July 20	1
Leslie Pierce					From July 20	1
INED proportion	3/8	4/8	4/8	4/8	5/9	-

Source: Credicorp annual reports 2014 to 2020

NB. Blue denotes Independent Director.

Until the Fujimori scandal broke, the board had been dominated by eight long-serving members with significant service, for example, with an average board service of 23 years. Three of these were denoted as INEDs but their length of service – 31, 17 and 14 years suggests that they were not independent at all. Post Fujimori, and by July 2020, five new directors had been appointed, putting the INEDs in the majority on the group board with average service of 7 years. The role of the new independents is seen as crucial.

*‘I don’t know what it was like in Peru in the past, but all of the subsidiaries have independent directors and some from other countries where governance is more advanced and more concrete, and we meet to discuss governance.’ (Respondent 22)*

*‘Now I am at Credicorp, I see the discussions, I enter the boards, I join the board committees, I listen to the discussions, so I do believe that Credicorp is genuinely trying to change for the better.’ (Respondent 22)*

However, one very long-serving director with 40 years’ service stayed on. In 2020, the presidency passed from Romero Paoletti to Romero Belismelis who has held

directorships in other businesses in Grupo Romero indicating that the Romero family shareholding still had strong representation on the board.

Until 2020, the group had six board committees in 2014 which were presided by the group President and one long-serving INED.

**Table 2: Credicorp board committees**

Presidency	Board Committees						
	Corp Governance. To 2019 Renamed	Exec To 2019 ELIM 2020	Nominations Merged with Compensation 2020	Compensation Merged with Nominations 2020	Risk	Audit	Sustainab. (Was Corp Gov)
Established – Discontinued/ Merged	2010 - 2019	2012 - 2019	2012 -	2012 -	2012	2002	2020
Members	3+	5	3	3 + GM	3 + 4 mgrs.	3+	6
Frequency	2	15	8	4	19	12	3
<b>Long-serving</b>							
Dionisio Romero Paoletti	2014 to 2019	2014 to 2019	2014 to 2019	2014 to 2019			
Morales Dasso (INED)					2014-2017 2020	2014-2019	
Ciguenas INED					2018/2019		
<b>‘New’ INEDS</b>							
Lizárraga						2020	
Gouvea			2020				
Aranzabel Harreguy							2020

The original six committees were established between 2002 and 2012, well before the launch of the code. By 2020 the ‘new’ INEDs three of the now four board committees. This involved the merger of Compensation and Nominations committees and the termination of the Executive committee. The original Corporate Governance Committee was renamed as the Sustainability Committee and the Deputy CEO was designated an executive sponsor and Head of Sustainability to coordinate efforts across the group. In the same year, Credicorp

created a new Sustainability Office, whose role is intended to “*transform Credicorp into a sustainable leader in Latin America; lead and supervise Credicorp’s novel and ambitious Sustainability Program; and ensure the Group acts as a protagonist on the sustainability stage over time.*” (Credicorp 2020: 155)

The new head of the SMV in 2019 was previously an executive at Credicorp though they disclaim any preferential treatment as a consequence, in fact the opposite:

*‘...(the SMV) has become very strict since he arrived and I also think that for Credicorp, it is even stricter, because in fact it has to show that it is obviously not influenced by the fact that their new head came from here – they have to create a distance and be seen to have no favourites.’* (Respondent 30)

These developments were extended to all subsidiaries which Credicorp coordinates through a matrix structure - each subsidiary is responsible for its own governance but works in a matrix with arrangements made on a practical basis according to the subsidiary. For example, BPC has shared directorships with the group:

*‘Of the 13 BPC directors, eight are also directors of Credicorp. So that is how all BCP’s decisions are made in agreement with the matrix’s decisions. Because those directors have knowledge of what is happening in the parent company, and they bring it to BCP.’* (Respondent 30)

Whereas Prima does not share directorships but does share committee memberships.

*‘Today there are no shared directors in Prima, it makes sense at BCP, because they are the majority of Credicorp, but not for us. I think it is important that Prima has its own board committees, but also adheres to a group of Credicorp committees with shared members. And there is a high level of coordination on financial plans and budgets.’* (Respondent 23)

The INEDs across the business seek to play an informal coordinating role.

*'...all of the subsidiaries have independent directors and some from other countries where governance is more advanced and more concrete, I know these independent directors and we meet sometimes to discuss governance.'* (Respondent 22)

External investors and the New York listing are important to the group and so Credicorp seeks to balance investors needs with 'behaving appropriately'. The implication is that they resist investors requirements for returns to establish ethical protocols in their lending and claim this is at the expense of short-term results.

*'We need to communicate with investors that we may need to sacrifice some return in the short term to make sure we can make this long-term positive impact. Of course, we must be profitable for investors but at the same time we should be looking to make a positive impact and that being well governed is good not only for the company, it should be also good for the shareholders and for the different stakeholders.'*

(Respondent 22)

The group was keen to acknowledge external accreditations with Judgement Validators. On the launch of the code in 2014, the firm announced the 'Awards' from La Voz del Mercado for recognition of its corporate governance, from Euromoney for being a best managed company in Latin America and to promote itself as the first firm in Peru to receive an international certification for quality in internal auditing issued by IAA, establishing them as a 'reference point' (Credicorp 2014: 24). In 2016 they added Awards from International Investor or coming in third place for 'Best CEO', Latin Finance's Bank of the Year Award for BCP, and ALAS 20 – VIGEO award for being a Leader Company in Investor Relations (ibid 2016: 23).

By 2020, with the new emphasis on sustainability, Credicorp referred to its signatory status to the Equator Principles, a risk management framework for environmental and social

projects, its adherence to the UN PRI, its membership and seat on the Governing Board of the PIR, its signatory status to the CDP, a global disclosure system for investors, companies, cities states and regions to improve environmental risk and its award of ‘C’ status (ibid 2020: 226, 7), along with 22 other awards, distinctions, certifications and endorsements, and 21 organisations of which it is a member through its subsidiaries(ibid 2020: 223)

Outside agencies are seen as having some more influence now on the firm’s behaviour than previously

*‘I believe that in reality all agencies have some influence on the behaviour of the company because their opinions count. Perhaps 10 or 15 years ago, Credicorp did not pay much attention to what was happening outside, I think that in recent years yes it has begun to listen a lot to what the stakeholders think and to take that opinion more and more into account.’ (Respondent 30)*

And the role of Judgement Validator is recognised and the impact they have on Evaluators

*‘We’ve always had very high compliance ratings early on. However, there was another component which is La Voz de Mercado which is how the "stakeholders" or brokerage houses, investment funds, local mutual funds, think of you.’ (Respondent 30)*

External agencies are not seen as the drivers of new behaviours directly however,

*‘I do not believe that Credicorp is strengthening its corporate governance because of what others say about Credicorp, but because the directors and the shareholders demand it, the directors believe in it and that is why so many changes are being made. But the fact that there are now more independent directors also forces management, forces us all to pay much more attention to these issues of corporate governance.’ (Respondent 30)*

## Judgement on the Weight of Evidence comparing pairs of hypotheses

On the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence is very implausible in the world of the Efficiency hypothesis. In the world of a firm making cost benefit calculations for each of the rules contained in the code, or even for the costs of compliance with the code overall, the evidence is quite unlikely to occur. The firm continually refers to its ethical policy, its commitment to the sustainability of its business and its commitment to ESG with particular emphasis on contributing to society directly and to protecting the environment through its lending and investment policies. This evidence does not sit at all well with a purely accounting basis of evaluation. In the world of the Power hypothesis, of a firm seeking to use compliance in a manipulative way as an expression of its own power, some of the older evidence could be seen to be plausible. At the time, two people controlled the board and board committees even though governance in the firm was evolving, but it only moved to INED control post disclosure of the payments and one of the same individuals, along with a new member of the Romero family remain in the VP and President roles. In this view, the extreme lengths to improve governance are an attempt to salvage reputation. However, I argue that the rather grand arguments provided by the previous chairman to justify cash payments to Keiko Fujimori was evidence of personal and not corporate power, and the programme to strengthen governance had demonstrably been underway from 2012. And the new board in 2020 with a majority of INEDs on the Board and presiding over board committees suggests that, representation of family shareholders aside, the culture at the top is changing and that the firm is not seeking to be duplicitous. I therefore rate the Weight of Evidence to be favouring  $H_P$  over  $H_E$ <sup>250</sup> as 3dB to reflect the minimum discernible difference between the likelihoods.

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<sup>250</sup> Denoted  $\log[P(E_C|H_E)/P(E_C|H_P)]$

On the second paired comparison, *Legitimacy and Power*, both the documentary and the testimonial evidence would most certainly be expected in the world of a firm seeking legitimacy for its governance and wider management processes, particularly post 2019. The firm has moved to an INED majority which run committees and had established a matrix approach to coordinating governance across its subsidiaries which democratizes much of the process and makes it more transparent. The group also needs legitimacy from outside providers - it is listed on the New York stock exchange and is aware of the need to present itself well to shareholders and providers of finance. The group also actively cultivates outside agencies and recognises explicitly the role Judgement Validators have in influencing Evaluators, although not the firm itself. Despite the evidence for reflexivity regarding governance in the widest sense, I sense a reluctance to make changes to the board, though this may have been driven by a need to see through changes to the organization before changing the leadership. I therefore rate the Weight of Evidence in favour of HL over Hp<sup>251</sup> as +20Db to reflect the strong difference between the likelihoods.

I summarize these judgements below (Table 3).

**Table 3: Weight of Evidence for Credicorp favours legitimacy-seeking**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence		
				HE	Hp*	HL
<b>Efficiency versus Power</b>						
P(ECc HE)	Implausible	$\frac{P(ECc HE)}{P(ECc HP)}$	Clearly in favour of HP	-3	0	-
P(ECc HP)	Somewhat Plausible					
<b>Legitimacy versus Power</b>						
P(ECc HL)	Very Plausible	$\frac{P(ECc HL)}{P(ECc HP)}$	Strongly in favour of HL	-	0	20
P(ECc HP)	Somewhat Plausible					
<b>Total Weight of Evidence for Credicorp</b>				<b>-3</b>	<b>0</b>	<b>20</b>

<sup>251</sup> Denoted  $\log[P(ECc|HL)/P(ECc|HP)]$

\*NB. Note HP is used as the base case in each pairwise comparison

My conclusion is clearly in favour of the legitimacy hypothesis for Credicorp.



### **A6.2.3 Arca Continental Lindley seeks efficiency and control**

#### **Background Information**

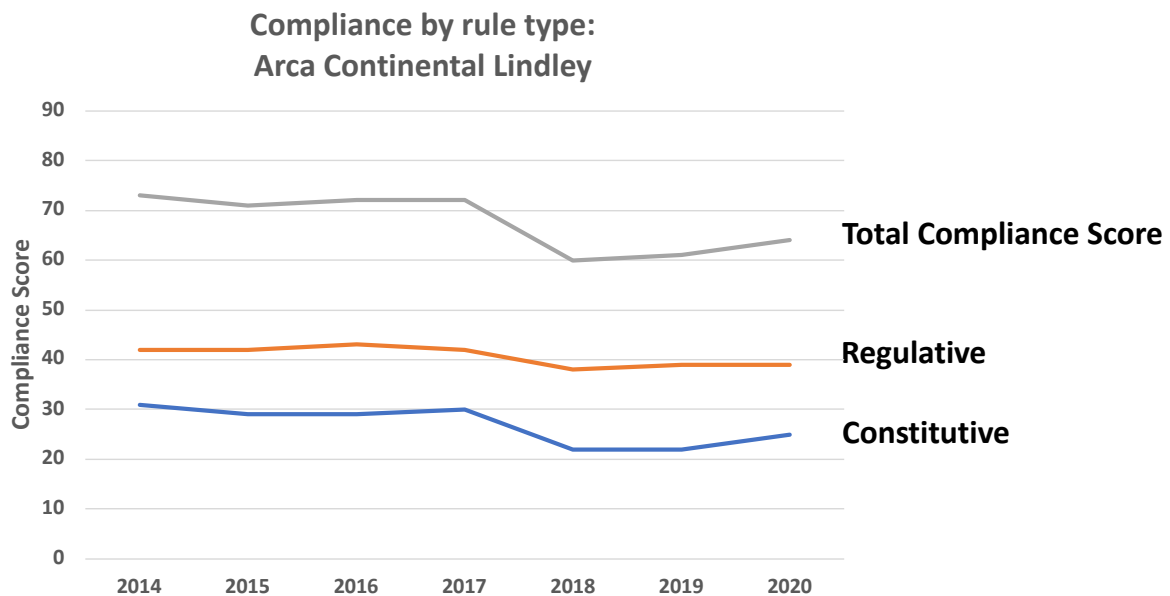
Arca Continental Lindley S.A. (also known as Corporación José R. Lindley S.A. or the Lindley Corporation) is a 100+-year-old Peruvian [company](#) established in 1910 by recent English immigrants to Peru. The firm manufactures, distributes and markets non-alcoholic beverages in Peru, is known for creation and marketing of [Inca Kola](#), the best-selling soft drink in Peru, and has developed a reputation for plastic recycling. Lindley began its relationship with Coca Cola in 1999 and is now the official bottler and distributor of all [Coca-Cola](#) products in Peru. In 2004, the Lindley Corporation acquired *Embotelladora Latinoamericana SA (ELSA)* through shareholdings enabling the company to optimize the use of resources, improve commercial performance of the system, and create a stronger competitive position and consolidated its acquisition the following year. From 2006 to 2009 the Lindley Corporation continued to dominate the development soft drink industry with a 65.7 percent market share and 73 percent value share in 2009. Lindley was taken over by Arca Continental in the purchase of two successive blocks of stock in 2015 and 2019. The firm has been involved in two financial scandals both involving business partners: first, with Coca Cola in 2014 over an issue of the valuation of a tranche of land for tax purposes and alleged political lobbying by Coca Cola, and second, with Arca Continental in 2015 over the valuation of shares in relation to legacy shareholders on the occasion of Arca's acquisition of a controlling stake in Lindley for which the firm received an SMV sanction.

## Highlighted Evidence

All company documents referenced in this section can be accessed from the corporation's website<sup>252</sup>.

ACL as Corporación Lindley maintained a moderately high level of compliance with the 2014 code until its staged acquisition by Arca Continental. The firm's compliance with constitutive rules was especially reduced – by almost one third from a constitutive compliance score of 30 to one of 22.

**Figure 1: ACL compliance by rule type**



The early Lindley annual reports emphasize business performance and financial and operational success, with little emphasis on governance per se. The early annual reports had a section entitled Governance, but this was dedicated to factual information listing the board members and senior management.

Although Lindley was involved in two minor scandals these were not seen to damage their reputation unduly. Regarding the share transaction in 2015, Lindley point out that

<sup>252</sup> *Memorias Anuales* at <https://www.arcacontinentallindley.pe/accionistas-inversionistas.php>

although there was a controversy over the share pricing which involved one institutional investor, they themselves were not at fault.

*'The claim of the retail investors was that they were not offered the same price as the major investors. But of course, when you buy the controlling shares, they have a different value. In the end, it was understood that it was not a case where we misled the market. The Superintendency of the Securities Market did not fine us for a difference in price but for a lack of transparency.'* (Respondent 21)

The incident was not seen to affect Lindley's consumer markets, because their customers were typically not shareholders or interested in the markets and seemed to be oblivious.

*'The average Peruvian is not a person who is interested in such matters, however sophisticated they may be. The farmers, the working class, the middle class, the kids, they're not reading the investment or finance journals, are they?'* (Respondent 21)

ACL experienced progressively increased influence on their governance first by Coca Cola then by Arca Continental. The relationship with Coca Cola as their sole distributor in Peru had introduced a great deal of operational discipline into the business because Coca Cola had standards which it applied globally. There seemed to be some ambiguity over how this influence was exercised.

*'Coca-Cola demanded certain standards from us, but it was not that it forced them on us. Having Coca-Cola as a partner obliged us to comply with their standards, of our own free will of course, but we couldn't easily resist.'* (Respondent 21)

Lindley had been undergoing a process of corporatisation before it was acquired by Arca.

*'The plan was initiated by the Lindley family to corporatize and to establish more formal governance.'* (Respondent 21)

The acquisition by Arca Continental introduced a centralized approach to governance and introduced new forms of management both because of their listing on the Mexico exchange and because of their group structure.

*'With Arca things have already gotten stronger. No longer even that decisions were made here - decisions are passed on to the jurisdiction of the parent company, we have absorbed all Arca's policies and procedures with a very positive the synergy.'*  
(Respondent 21)

Arca Continental used a matrix structure to reinforce its approach to governance and has introduced a functioning whistle-blower process reporting to an Ethics Committee.

*'We work under a matrix structure in order to ensure independence of decisions and have healthy counterweights in business administration. For example, I am in charge of the Administration and Finance Department of Arca Continental Lindley, and I report to a general director of Peru, but in the matrix, I report to the Corporate Administration and Finance director in Arca. With this we ensure a cross check.'*  
(Respondent 27)

*'We also have an Ethics and Compliance Committee and an anonymous transparency mailbox, both for employees, for clients, for suppliers and for the general public, where anonymous complaints are received. And the function of this ethics committee is to investigate, evaluate and respond to these complaints.'* (Respondent 27)

Arca Continental appears to have opted to take Lindley out of the BVL good governance index.

*‘we have not participated in the BVL’s good corporate governance index since 2015 - this a decision that the parent has made for us not to participate in the index, but it does not mean that we don't care about governance.’ (Respondent 19)*

Otherwise, Arca allows Lindley to report freely to the SMV on governance except insofar as it insists on certain protocols over *issues of importance*<sup>253</sup> because disclosure could affect other group companies’ valuations.

*‘We must inform the regulator and Arca at the same time because we are a subsidiary of Arca Continental Bebidas, which in turn is a subsidiary of Arca Continental. So, if any of the "holding" companies, had any material fact that could under Peruvian law have any impact on the actions of Peruvian company, on the movement of shares or on the criteria of the sensible investor, which could affect or improve their position, we are obliged to disclose it.’ (Respondent 21)*

The acquisition had a profound impact on the Lindley Board resulting in a complete change of personnel, except for two individuals: the President, a Lindley family member who stayed in role, and an INED since 1997 and a holder of B class shares in Lindley (ACL 2014: 13,14).

**Table 1: Developments to board composition – Corporación Lindley**

Director	App	Year							Years Served
		2014	2015	2016	2017	2018	2019	2020	
Lindley Suarez *	04	Reapp President	Reapp President	Reap President	Reap President	Reap President	Reap President	Reap President	16
Ponte González	?		Reapp	Reapp	Reapp				
John Murphy	03 12	Reapp	Reapp	Reapp	Reapp				5
Zaranzúa López	03 10	Reapp	Reapp	To 07 16					6

<sup>253</sup> *Hechos de Importancia*: a protocol established by financial markets that issuers must report promptly on matters that may affect share prices, such as transactions, loans, provision of guarantees, changes to financial forecasts etc. The SMV list 23 items, plus a 24<sup>th</sup> catch all denoted “other”.  
[https://www.smv.gob.pe/SIMV/Frm\\_HechosDeImportancia?data=878CA717F98621758AAB599D555152224D59ED3924](https://www.smv.gob.pe/SIMV/Frm_HechosDeImportancia?data=878CA717F98621758AAB599D555152224D59ED3924)

Riviera Garcia	03 13	Reapp	Reapp	To 07 16					4
Gnani Braun	09 16	-	-	App 09 16	Reapp				1
Gearhart Colton	09 16	-	-	App 09 16	Reapp				1
Arredondo Lindley*	05 05	Reapp	Reapp	To 07 16					
Diez Canseco	03 13	Reapp	Reapp	To 07 16					4
Carranza Ugarte	03 13	Reapp	Reapp	To 07 16					4
Rodríguez Larraín Salinas*	97 10 18	Reapp	Reapp	To 07 16	-	App 10 18	Reapp	Reapp	3**
Kharim Yahi	2017					App			
Santos Reyna	09 15	-	App VP	Reapp VP	reapp	Reapp VP	Reapp VP	Reapp VP	6
Garza Egloff	09 15	-	App 09 15	reapp	reapp	Reapp	Reapp	Reapp	6
Gutiérrez Hernández	09 15		App 09 15	reapp	reapp	Reapp	Reapp	Reapp	6
González Quiroga	04 18	-	-	-	-	App 04 18	Reapp	Reapp	3
Kisic Wagner	10 18	-	-	-	-	App 10 18	Reapp	Reapp	3
Solbes Simón	10 18	-	-	-	-	App 10 18	Reapp	Reapp	3
Indep:director		3/8	3/11	3/	0/8	3/8	3/8	3/8	

It is clear that before the acquisition Lindley were stretching the meaning of independence and apparently confusing the notions of independent director with non-executive director, and this individual was reappointed in 2018. Apart from some years when the board was in transition and there were no INEDs in 2017, the number of INEDs has been maintained at a complement of three, suggesting a commitment to do the minimum with regard to INED appointments, irrespective of the size of the board. Board committees get a single mention in 2014 where Lindley announce setting up four committees covering Strategy & Business, Nominations & Remuneration, Risk & Investment, and Corporate Governance.

Lindley had a relatively short annual report in 2014 at 54 pages. The document grew until a peak in 2018 with 174 pages and then declined in 2019 and 2020 with 98 and 95 pages respectively.

Lindley reduced its code compliance post acquisition, particularly with respect to constitutive rules, but prefers to use a more positive third-party evaluation. Lindley's stated policy on governance is to make steady progress. However, in practice, Corporation Lindley had a relatively high level of code compliance 2014 to 2017, but in 2018 the level of compliance dropped by 12 points from 72 in 2017 to 60 in 2018 coincident with the Arca acquisition. Eight of these reductions occurred in constitutive rules which dropped from 30/44 to 22/44.

This issue proved difficult to explore in practice with respondents because Lindley were running a parallel assessment of their governance using outside assessors (PWC then KPMG). This process was closely related to the 31 Principles embodied in the 2014 code but at an aggregated level, not using the 88 items in the code. This gave Lindley the impression that they were *continuing to improve* their governance in 2018.

*'In 2015, it was 65.21, and 2016 was from 74.15. In other words, we increased almost ten percent, between 2015 and 16. That was the product of the work to improve. For the 2018 financial year, it was made by KPMG and in 2018 we got 79.27. So we continue to improve our index. It seems to me that 2018 raises the fence of the minimum score to apply for the index of good corporate governance from 75 to 80.'*

(Respondent 21)

It seems that the external evaluations are both a more positive and flexible way of presenting their governance performance rather than relying on the SMV returns.

*'Of course, this is an «assessment» for which we paid to be evaluated. The SMV has its own regulations, but you cannot reply to the SMV at all. The difference is that when the Big Four gives us the score, we review it, and that is where we have a right to improve or correct what we do not agree with.'* (Respondent 21)

The topic of governance remains important to ACL because the local and international bond markets are of ongoing importance. Lindley had been active in the bond markets beginning in 2011 with an issue in New York intended both to restructure short term debt and to invest in new plant, followed in 2016 by an offer on the BVL. At the end of the year, Arca Continental Lindley four open obligations, mainly issued in New York:

- International corporate bonds: S/ 924,120,000 (US\$ 255,000,000).
- Local corporate bonds: S/ 150,000,000.
- Local bank loans: S/ 80,000,000.
- Premium call spread finance: S/ 613,617.

Bonds issued in Lima and New York 2011 and 2013 to expire in 2021 and 2023. Lindley noted that in 2017, their rating by Fitch Ratings was raised from BBB+ to A-, somewhat higher than that of Peru itself. (2020:22,38)

There appears to be a clear relationship between being seen to be taking governance seriously and the bond market, which might explain the firm's enthusiasm to present its governance in a favourable light.

*'Everything resonates. An AFP, which is very scrupulous with corporate governance issues, many times will not want to invest in a company, or buy the bonds of a company, which does not take corporate governance seriously. We are aware that it is a win for all.'*

Maintaining a high credit rating is seen as important for future fund-raising:

*'The only companies in Peru that have maintained their double A + rating are us and Petroperú. We are above the rating of the Peruvian State.'* (Respondent 19)

This requires effort because the international markets are considered to be stricter than the domestic

*'The US standards are stricter than the Peruvian ones with a higher standard for compliance. Having the bonds, and having paid what was due on time and, in having*



*reduced our level of exposure, has allowed our ratings by risk rating companies, to have been of the highest rating.* (Respondent 19)

Arca Continental Lindley reported its association with multiple external sources of recognition for its governance and performance. These included rankings by MERCO, a Spanish ratings firm which put ACL 19<sup>th</sup> in the companies ranking; 12 for talent and 3- for responsibility and governance. Together with Coca-Cola, the Company was one of the first companies to receive the Seal of Recognition and diploma for complying with 100% of the goals established in the Agreement for Clean Production (APL), awarded by the Ministry of the Environment. For the seventh consecutive year, recognition as a Socially Responsible Company (ESR), awarded by the Peru association 2021, the Company being chosen as a company example of good practice in the category 'Environmental'. ACL also received recognition as a company "Leader of Change 2020" by the Association of Good Employers (ABE), of the American Chamber of Commerce AMCHAM, for good labour practices in the context of COVID-19, on leadership issues, health, and experience of the employee.

(2020: 47,48)

The notion of Sustainability has always been important to the firm because of its operational footprint and the need to manage its relationships with local communities. Coca Cola plays an important role regarding environmental sustainability, and much is made of the firm's sustainability policy. In practical terms, this is reflected in how the firm manages its water consumption with regard to local communities.

*'I believe that one of the best areas of the company is that in charge of sustainability and social responsibility The fact of being large consumers of water also has a social impact that we manage very well. Just as we take from nature, we give it back and*

*also we give back to the population the resources they might think we took.'*

(Respondent 21)

Also of concern is the need to reduce the production of plastic (PET) in bottles.

*'We are a company that consumes PET and we are in industry that has an impact on the environment, and we are aware of that and we do everything in our power to reverse or lessen the impact on the environment. The Coca-Cola system is more demanding than the regulation of the State so since Coca-Cola became our strategic partner, we have had more stringent internal regulations over PET that are much friendlier with the environment than any of our competitors.'* (Respondent 21)

### **Judgement on the Weight of Evidence comparing pairs of hypotheses.**

On the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence is very plausible in the world of the Efficiency hypothesis. Lindley appear to have delegated some aspects of their governance to the matrix operated by the Arca group with the result that they no longer need to comply with several code rules. Given the focus of such a business on operating expense control in the bottling and distribution of a commodity consumer product, this evidence would appear to be very plausible in the world of the Efficiency hypothesis. However, the highlighted evidence of using the external assessment of compliance based on principles rather than the code itself, and the framing of a decades-long veteran and shareholder as an INED combine to suggest the firm is quite happy to give false messages regarding the code. These actions are plausible in the world of the Power hypothesis, that is, a firm seeking to use compliance in a self-serving or manipulative way.

I therefore rate the Weight of Evidence to be clearly in favour  $H_E$  over  $H_P$ <sup>254</sup> as 10dB, that is the plausibility of the evidence under Power offsets but does not entirely balance the very high plausibility of the Efficiency hypothesis.

On the second paired comparison, *Legitimacy and Power*, in the world of a firm seeking legitimacy for its governance and wider management processes both the highlighted evidence would most certainly be expected to occur. Lindley is a firm that is very clearly subject to four sets of relationship: its globalized owner with responsibilities to the Mexican stock exchange, an iconic global branded supplier in Coca Cola, the bond markets and institutional investors which they comprise, and local stakeholders crucially concerned about water supplies. ACL clearly pursues legitimacy in each of these relationships and is keen for the endorsement of Judgement Validator. But much of this legitimacy seeking is operationally focussed, not related to the aspects of governance covered by the code, and for the code, they subvert the process by bringing in pwc to endorse an alternative to code compliance. It is clear that both Coca Cola and Arca is not above taking short cuts if they believe the prize is worthwhile and they both demonstrated sharp practice in the documented scandals, albeit of limited scale. In the world of a firm seeking to use compliance in a self-serving or even manipulative way the evidence of presenting a favourable version of governance would seem to be more plausible. I therefore rate the Weight of Evidence in favour of  $H_P$  over  $H_L$ <sup>255</sup> as +15Db to reflect the (fairly) strong difference between the likelihoods.

I summarize these judgements below.

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<sup>254</sup> Denoted  $\log[P(ECL|H_E)/P(ECL|H_P)]$

<sup>255</sup> Denoted  $\log[P(ECL|H_L)/P(ECL|H_P)]$

**Table 2: Weight of Evidence for ACL favours efficiency-seeking**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(ECL HE)	Extremely Plausible	$\frac{P(ECL HE)}{P(ECL HP)}$	In favour of HE	10	0	-
P(ECL HP)	Plausible					
<b>Legitimacy versus Power</b>						
P(ECL HL)	Plausible	$\frac{P(ECL HL)}{P(ECL HP)}$	Clearly in favour of HL	-	0	<b>-15</b>
P(ECL HP)	Plausible					
<b>Total Weight of Evidence for ACL</b>				<b>10</b>	<b>0</b>	<b>-15</b>

\*NB. Note HP is used as the base case in each pairwise comparison

This conclusion is in favour of the Efficiency hypothesis for Arca Continental Lindley.

#### **A6.2.4 Compañía Minera Poderosa illustrates power maintenance.**

##### **Background Information**

Compañía Minera Poderosa (CMP) was established in 1980 and is engaged in mineral exploitation, extraction, processing, and trading with a focus on underground gold mining. The company operates two plants: Marañón in Vijus and Santa Maria located in Santa Maria, Pataz. The Marañón plant treats more than 500 tons of gold per day and the Santa Maria plant treats more than 150 tons. The company owns and operates the Poderosa Mining Complex in the Pataz region of Northern Peru. Gold production in Peru is very fragmented, and although it is a relatively small firm in comparison with others listed on the BVL, CMP is the leading producer of gold with c 9.5% of annual production of 97.3 metric tonnes in 2021, with Compañía de Minas Buenaventura in seventh place with 3.8%. CMP is a very profitable business with high gross and net margins, high return on capital, an efficient use of financial assets and shows consistent growth.

CMP is of interest as a case study for three reasons: it operates in the mining sector, one which is of great importance to Peru and concerned with issues of environmental and societal management, but has a low level of compliance even for the mining sector; it clearly practices legitimacy seeking, but not with respect to the governance code; and it is owned by a controlling family and others who have a legacy approach to governance.

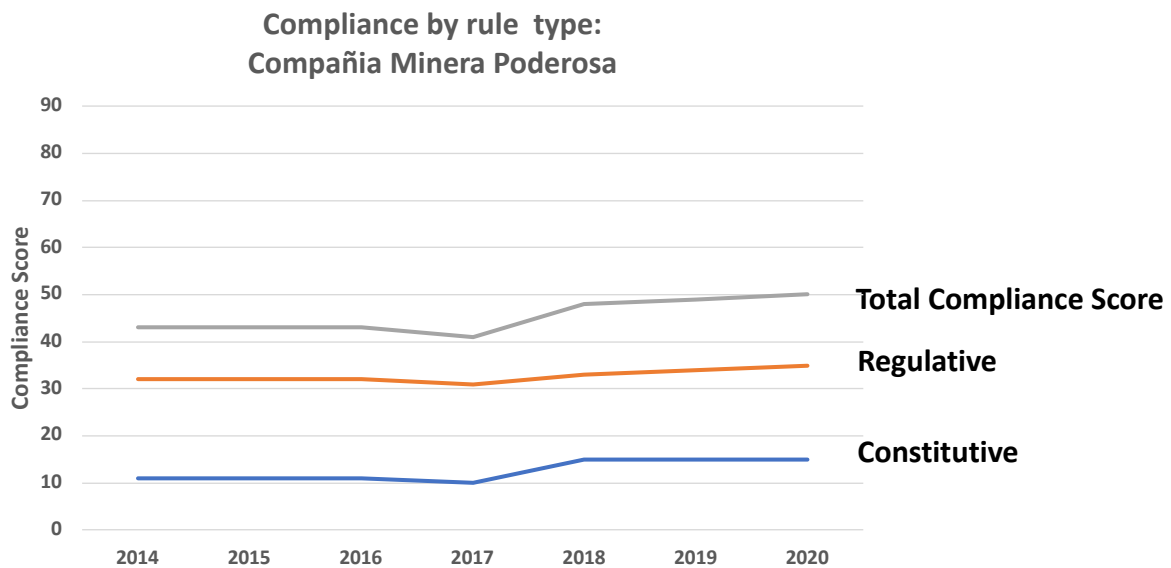
##### **Highlighted Evidence**

CMP's overall level of compliance with a score of 13 points<sup>256</sup> below the listed sector average. This shortfall is especially pronounced with constitutive rules – until 2017, it complied with just ten of the 44 constitutive rules, compared with the listed sector average of 18.2 points, although there was an increase between 2017 and 2018.

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<sup>256</sup> 2014 12.1 points below the mean, 2015 12.4, below 2016 13.5 below, 2017 15.7 below

**Figure 1: CMP compliance by rule type**



This low level of compliance has little to do with CMP being in the mining sector per se – CMP has the fourth poorest compliance of the 15 listed mining firms with three, Minas Buenaventura, and two Nexa Resources operations scoring over 70.

CMP is owned by a small number of families and funds with unclear provenance. There are seven large shareholders: two private individuals from the Arias Vargas family who own c28% of issued shares, five operating companies and/or funds have a cumulative c56%, and c16% is in the hands of smaller shareholders. However, only one of these funds appears to be an investment/operating company. **Talingo Corporation, Zulema Investment and Xelor Shipping** are Virgin Islands registered and are likely holding companies to obfuscate direct ownership. **Cori Apu SA**<sup>257</sup> (more recently CcoriApu!) was established in 2009 also appears to be a holding company with no operations or employees but with the involvement of two CMP directors - Carolina Castro (NED) (apparently as lawyer) and Victor Cayetano, (Director), Cori Apu bought their shares in CMP from Corporación Minera San Manuel S.A itself established in 2004 and with no employees or activity, and are listed as

<sup>257</sup> <https://www.datosperu.org/empresa-ccori-apu-sac-20521134748.php>

a client of Rosello<sup>258</sup>, a legal firm which advised Cori Apu in the acquisition of part of the capital shares from Compañía Minera Poderosa S.A. sold by Corporación Minera San Manuel S.A. (Rosello 2022). **South American Mining Investments** appears to be a private investment company with c50 employees established in 2016 and which acquired in 2017 the Breapampa mine from Minas Buenaventura and does appear to be a valid institutional investor<sup>259</sup>: The firm is a private enterprise created in 2016 which operates the Breapampa mine, located in Southern Peru along with a portfolio of mining assets in Peru (gold, silver, copper). Their stated strategy is to: “*acquire small / medium size operating mines or projects close to production that have the potential to take them to greater capacity and profitability*”<sup>260</sup>.

This structure appears to be reminiscent of the descriptions of family *grupos* in Monsalve’s account of the evolution of governance in Peru and of Schneider’s description of corporate behaviour under hierarchical capitalism where ownership is occluded by a range of organizational structures.

CMP has a relatively large board that is controlled by a long-serving family/shareholder group. The table shows CMP’s board composition 2016 to 2021.

**Table 1: CMP board membership**

Director	Year of App	Year						Years Served
		2016	2017	2018	2019	2020	2021	
Evangelina Arias (President)	05/1980	Y/E	Y/E	Y/E	Y/E	Y/E	Y	41
Walter Sologuren	03/1987	Y/E	Y/E	Y/E	Y/E	Y/E	Y	34
Victoria Arias	03/1991	Y	Y	Y	Y	Y	Y	30
Ana Arias	03/1997	Y	Y	Y	Y	Y	Y	24
Víctor Cayetano	03/1999	Y	Y	Y	Y	Y	Y	22
José Picasso	11/2006	Y/E	Y/E	Y/E	Y/E	Y/E	-	14
Ricardo Revoredo	08/2007	Y	Y	Y	Y	Y	Y	14
Jorge Picasso	04/2009	Y	Y	Y/E	Y/E	Y	Y	12

<sup>258</sup> <https://www.rossellolaw.com/inicio.php?idioma=English&opcion1=operaciones&opcion2=corporativo>

<sup>259</sup> <https://www.samilatam.com/inicio>

<sup>260</sup> <https://www.linkedin.com/company/south-america-mining-investments-sac/>

Rafael Picasso	04/2009	Y	Y	Y	ALT	Y	Y	12
Adolfo Arias	04/2009	Y	Y	Y		Y	Y	12
Fernando Cantuarias	04/2009	Y	Y	Y	ALT	Y	Y	12
<b>Average service(yrs)</b>		-	-	-	-	-	-	20.7
José de Bernardis	03/1998	Indep	Indep/E	Indep/E	ALT/E	Indep/E	Y	23
Juan Assereto	04/2001	Indep	Indep	Indep		Indep	Y	20
Eduardo Ferrero	08/2007	Indep	Indep	Indep	ALT	Indep	Y	14
Guido Vingerhoets	04/2009	Indep	Indep	-				12
Carlos García	04/2009	?	Indep	-				8
Daniela Polar	09/2010	?	Indep	-				7
Juan Proaño	04/2009	Indep	Y	Indep	ALT	Indep	Y	12
Carolina Castro	04/2012	Indep	Indep	Indep	ALT	Indep	Indep	9
José Marún	04/2017	-	Indep	Indep		Indep	Indep	5
Carlos Aranda	08/2017	-	Indep	Indep	ALT	Indep	Indep	5
Luis Marchese	08/2019				ALT	Indep		2
<b>Total</b>	-	17	21	18	15	19	18	-
<b>INED/D ratio</b>	-	6/17	9/21	7/18	n/a	8/19	3/18	-

Source: CMP's annual accounts, detail not available for 2014 or 2015

CMP has had a consistently large board with an average membership of 18.8 members compared with the Peruvian average of 7-8 members. Many CMP directors are very long-serving with an apparent core group of at least 11 members with an average continuous service of 20.7 years though it is notable that one individual has served on the board for 41 years, much of it as President, since the firm was established in 1980. Three of this core group are also shareholders, and of the 23 members listed, the family names Arias, and Picasso appear several times.

On closer inspection, there are some issues over the role of INEDs. CMP has had directors named in their annual accounts as independents, but the de facto notion of independence is suspect for three main reasons: the number and identities change frequently from 9 in 2017 to 3 in 2020 implying no consistent policy towards INED recruitment and role allocation; there appears to be a porous boundary between executive and independent directors – at least four initially independent directors become full directors rather than, as is more normal, departing the firm after serving a number of three-year terms before their



independence is compromised through over familiarity; and some of the independent directors have also served for very long terms, for example, 20 and 23 years, rather than three, six or nine years, and so can hardly be considered as independent; and finally the 2021 complement of 3 INEDS (to the number recommended by the 2014 code) in a board of 18 hardly speaks to support of the concept of independent challenge even though CMP appears to abide by the letter of the code. The impression created is that CMP wishes to present itself as complying with parts of the code but in practice they are not following the spirit of the code regarding independent directors and their role on a board. all of which call into question the INEDs real status as independents and to question their role on the board.

Regarding board committees, apart from an executive committee which has been in operation since 2008, CMP only recently established board committees in 2018 when three were established: Audit, Ethics & Governance and Strategy & Sustainability. However, two topics frequently covered by board committees, Risk and Nominations & Remuneration, are not addressed through the committee structure.

On close inspection, the staffing of these committees is unusual, especially that of the executive committee.

**Table 2: The CMP executive committees are tightly controlled**

Director	Year of App	Year							
		2014	2015	2016	2017	2018	2019	2020	2021
Evangelina Arias	2007	President	President	President	President	President	President	President	President
José Picasso	2007	Member	Member	Member	Member	Member	Member	Member	Member
Victor Fernandez	20007	Member	Member	Member	Member	Member	Member	Member	Member
José de Bernardis	2015		Member	Member	Member	Member	Member	Member	Member
Jorge Picasso	2018					Member	Member	Member	Member
Juan Assereto	2018					Member	Member	Member	Member
Walter Sologuren	2018					Member	-	Member	Member
<b>Total</b>		3	4	4	4	7	6	7	7

<b>INED/D ratio</b>		-	1/4	1/4	1/4	2/7	2/6	2/7	2/7
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The table shows the membership of the executive committee which meets weekly. However, the Executive Committee is unusual for several reasons: First, it is chaired by the President of the company who would appear to be also operating as Chief Executive Officer, yet the joint President/CEO role indicated as undesirable in the 2014 code. Second, it is staffed by, over time, an increasing number of full board members rather than executive managers who would oversee departments. Third, it also includes one INED, a very unusual inclusion in an executive committee, since one of the roles of the INED is to have independence from management, not to have direct dealings in executive matters and not to meet weekly to run the business.

The three new committees established in 2018 are similarly tightly controlled by the company President.

**Table 3: CMP board committee composition**

<b>Director</b>	<b>2018 Committee Composition</b>		
	<b>Audit</b>	<b>Ethics and Governance</b>	<b>Strategy and Sustainability</b>
Evangalina Arias	President	President	President
Victoria Arias		Member	
José Picasso	Member		Member
Victor Fernandez	Member	Member	Member
Ricardo Revoredo		Member	
Jorge Picasso	Member	Member	Member
Walter Sologuren	Member		Member
José de Bernardis	Member		Member
Juan Assereto		Member	
José Marún	Member		Member
Eduardo Ferrero		Member	
Juan Proaño	Member		Member
Carolina Castro		Member	
<b>Total membership</b>	8	8	8

<b>INED/Director ratio</b>	3/8	3/8	3/8
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Source: Analysis of CMP Memoria 2014 to 2021

NB. Blue indicates INEDs.

The table shows the membership of the new committees when they were established in 2018. All are chaired by the main board President of 41 years' service, and although other board directors are drawn into the membership, two other long-serving board members appear on all three committees. The complement of INEDs is low at three members per committee and so not a majority, even though this could be possible given the number of serving INEDS. So, in sum, it would not appear that the committees will provide any independence of thought that differs from the controlling and long-serving board members and, perhaps apart from the Audit committee, are merely a device to break up the workload, however, the means of implementation is not in line with the 2014 code.

As I noted above, CMP's level of constitutive compliance increased by seven points between 2017 and 2018 and this appears to be due to the introduction of a new approach to the audit function and is consistent with the establishment of the Audit Committee in 2018.

CMP seeks external recognition but focusses on the technical and operational aspects of its governance and is actively interested in external engagement for its sustainability practice. CMP obtained certification in 2009 for ISO 9001 and ISO 14001 along with OHSAS 18001 for its business operations and in 2019 for ISO 37001 for anti-corruption. In just 2019/2020 CMP was noted for eight awards covering achievements in business performance operational excellence and care for the community: Exporter 2020 granted by the regional government; Distinction for social responsibility (ESR) granted by the Mexican centre; Sponsor of the PUMII UNI engineering team noted by the National Engineering University; Member of the Quality Social Entrepreneurs awarded by the association of Good Employers (ABE); Recognition and thanks for supporting artisanal mining granted by the mining and hydrocarbon unit of the regional government; Noted Regional Exporter for the

Libertad region granted by the regional government and chamber of commerce; National prize for 5S awarded by AOTS; Award for good stakeholder relations awarded by the University of Trujillo and Grupo Hierro Communications.

It is perhaps not surprising that as a mining company, CMP is especially focussed on the local community. For example, in 2006 the Pataz Association<sup>261</sup> was established as a not-for-profit institute to offer sustainable development involving initiatives for the local community in healthcare support (sanitation management, water treatment, nutrition, and community surveillance), and education (technology support to junior schools, school equipment and furniture and community support) In 2009, CMP launched a forestation project with the planting of 3 million trees (c2,109 hectares), in 2017, its first declaration of sustainability and in 2018 their ‘7 rules of gold’, a checklist of safety procedures for operations staff and published its policies for management, quality working, environmental protection and security.

### **Judgement on Weight of Evidence comparing pairs of hypotheses.**

On the first paired comparison, *Efficiency and Power*, in the world of the efficiency hypothesis the evidence is rather implausible. The business is reported as being very profitable and growing and there is no indication that they are seeking to control operating expenses nor costs of governance. Indeed, large frequent meetings would not seem to be a cost-effective way of running the business. This evidence is very much more plausible in the world of the Power hypothesis where direct control was prioritized over cost-effectiveness. However, in relation to the governance code the occluded ownership structure, the large board dominated by a very long serving control group, the recent establishment of board committees but the absence of either a Nominations or a Remuneration committee, and the

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<sup>261</sup> [www.asociaciopataz.org.pe](http://www.asociaciopataz.org.pe)

controlling approach taken to committee presidencies and committee structures, the haphazard approach to INEDs and the blurring of the notion of are all very plausible in the world of the Power hypothesis. I therefore rate the Weight of Evidence to be favour of Hp over He<sup>262</sup> as +30dB to reflect the very strong difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, some of the highlighted quantitative evidence, especially the paternalistic care taken to work with the local community and the observance of standards with regard to mining operations and environmental protection are to be expected in the World of a Legitimacy hypothesis but not in relation to the governance code and the disregard for the spirit of the governance code in favour of observing the letter suggests strong consistency with the world of the Power Hypothesis for which environmental and societal legitimacy seeking are existential issues. I therefore rate the Weight of Evidence in favour of Hp over HL<sup>263</sup> as +20Db to reflect the discernible difference between the likelihoods.

These judgements are summarized in the table along with the intermediate plausibility evaluations in each world.

**Table 4: Weight of Evidence for Compañía Minera Poderosa favours Power hypothesis**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence		
				HE	HP*	HL
<b>Efficiency versus Power</b>						
P(EMP HE)	Implausible	$\frac{P(EMP HE)}{P(EMP HP)}$	Very strongly favour of HP	-30	0	-
P(EMP HP)	Very Plausible					
<b>Legitimacy versus Power</b>						
P(EMP HL)	Not Plausible	$\frac{P(EMP HL)}{P(EMP HP)}$	Strongly in favour of HL	-	0	-20
P(EMP HP)	Very Plausible					
<b>Total Weight of Evidence from CMP</b>				<b>-30</b>	<b>0</b>	<b>-20</b>

<sup>262</sup> Denoted  $\log[P(EMP|HE)/P(EMP|HP)]$

<sup>263</sup> Denoted  $\log[P(EMP|HL)/P(EMP|HP)]$

\*NB. Note HP is used as the base case in each pairwise comparison

This conclusion is very strongly in favour of the Power hypothesis over the two rivals explanations for decision-making regarding the governance code for Compañía Minera Poderosa.

## **A6.2.5 Graña y Montero (Aenza) illustrates legitimacy-seeking.**

### **Background Information**

Graña y Montero was the largest construction firm in Peru with an impressive record of growth through acquisition and organic development and a long list of impressive infrastructure projects to its name. The firm had developed beyond its origins in construction in Peru to operating 26 subsidiaries in four lines of business, engineering and construction, infrastructure, housing, and services, operating in 8 countries in Latin America with, *at its peak in 2014*, revenues of c \$2.5bn and net profits of c \$100m<sup>264</sup>. The firm became involved with Odebrecht, Brazil's largest construction company, when it entered Peru in 1979 and became Odebrecht's main partner outside Brazil. In Peru, Graña y Montero was involved in the procurement, extension and execution of infrastructure projects which were procured with bribes of the order of \$29m delivered to Peruvian officials. This activity took place during the presidencies of Alejandro Toledo (2001-2006), Alan Garcia (2006-2011) and Ollanta Humala (2011-2016), all of whom were implicated. When the so-called Lava Jato investigations in Brazil led to the disclosure of massive bribery involved in the tendering and development of public contracts in Peru, Graña y Montero was found to have been very heavily involved in the bribery and complicit with Odebrecht. In March 2016, the Brazilian Federal Court sentenced businessman Marcelo Odebrecht, chief executive of Odebrecht, to 19 years and four months in prison for his involvement in the case. As Odebrecht's partner in Peru and participant in six major construction projects<sup>265</sup> acquired in the period 2005 to 2014, Graña y Montero suffered rapid and significant damage in 2017 including: directors being indicted initially for bribery, and later for collusion and money-laundering; resignations of the board

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<sup>264</sup> One of the drivers for corruption in the infrastructure sector is that it is a relatively low margin business – here GyM earned 4% net profits in its peak year. The total bribes paid in Peru amounted to little more than 1% of 2014 revenues.

<sup>265</sup> GyM/Odebrecht projects in Peru: *Chavimochic* irrigation project stage 3; *Olmos* irrigation and hydropower project; South Peruvian Gas Pipeline; the Lima Metro Lines 1 & 2; *Chaglla Húanuco* hydroelectric plant

and senior management; 60% drop in share price; termination of contracts; withholding of assets; payment of fines and reparations; and detentions.

By 2019, the firm was rebranded Aenza with some on-going projects in Peru but achieved less than one half of Graña y Montero’s 2014 revenues and the sale of a controlling stake was agreed later to be sold to an equity fund and the exit of the Graña family.

### Highlighted evidence

I address the period up to and including the Lava Jato disclosures because these represent the behaviour of the firm with regard to governance and its response to the allegations and subsequent prosecutions. I will not address how the company reinvented itself as an ongoing entity in the form of Aenza.

GyM is majority owned by institutional investors, but close inspection suggests that two of the funds amounting to almost 23% of the firm are family funds and each have a direct representative from the family on the board. GyM did also maintain very stable relationships with three institutional shareholders until its demise.

**Table 1: GyM had a very stable group of institutional shareholders until 2017**

Shareholders	Shareholding (%)					
	2014	2015	2016	2017	2018	2019
GH Holding Group	17.81	17.81	17.81	17.81	16.11	13.48
Bethel Enterprises	5.12	5.12	5.12	5.12	4.63	
<b>Total family</b>	<b>22.93</b>	<b>22.93</b>	<b>22.93</b>	<b>22.93</b>	<b>20.74</b>	<b>13.48</b>
JP Morgan Chase	38.46	38.46	40.18	39.29		
APF Integra	6.11	6.01	5.82	4.74	9.91	8.29
Profuturo AFP	5.68	5.6	5.6	3.51		
BNY Mellon					28.51	24.69
Pacifico Corp SAC						10.0
Fratelli Investment					8.03	8.34
<b>Total Institutional</b>	<b>50.25</b>	<b>50.07</b>	<b>51.6</b>	<b>47.54</b>	<b>46.45</b>	<b>51.32</b>
<b>Sub total</b>	<b>73.17</b>	<b>72.57</b>	<b>74.52</b>	<b>70.47</b>	<b>67.19</b>	<b>64.8</b>
Other Shareholders	26.83	27.43	25.48	29.53	32.81	35.2
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Annual report pages</b>	468	469	453	412	187	179
	<b>69</b>	<b>30</b>	<b>20</b>	<b>112</b>	164	179



Post disclosure, only one of the original institutional investors, AFP Integra, maintained its shareholding.

It is important to note two aspects of the Lava Jato case which are not just background information but have discriminatory value: first, that the Lava Jato charges brought against GyM related to six projects that had been sold in the period 2005 – 2014. The bulk of this time was before the launch of the code and so, apart from a small overlap in 2014, it would certainly be unfair to claim that the code was especially at fault in not catalysing the disclosure of corruption. Alternatively, one could perhaps hypothesise that the advent of the governance code may perhaps have been interpreted as the end of an era and that was why the bribery had stopped by 2015. Second, the bribery was driven by Odebrecht working through a designated office wiring with electronic payments and offshore accounts ( ). GyM clearly benefitted from the corruption by winning the six contracts and paid Odebrecht later, but the initiative was limited to the President, past and current CEO and another board director, that is four people<sup>266</sup> who either resigned and/or who were indicted, and not the wider organisation of GyM itself.

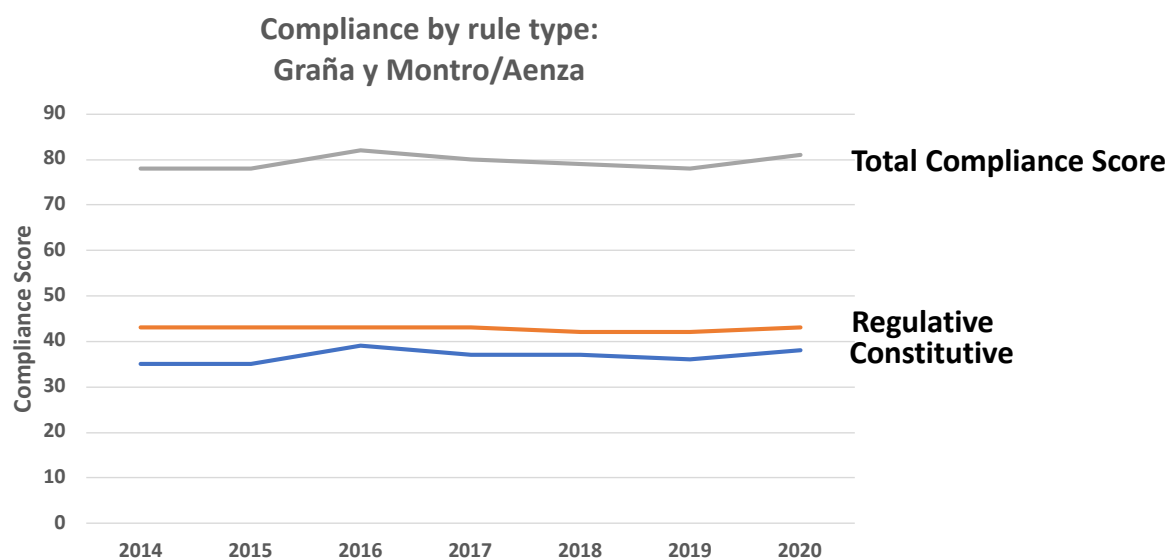
That said, Gym was also a long-standing member of the Construction Club along with COSAPI, and so there must have been a level of institutional knowledge of the price fixing that had been involved.

Graña y Montero (GyM) had a reputation for maintaining a very high level of compliance with the 2014 corporate governance code with a consistent compliance over 90% putting them in the top dozen firms in Peru and this performance was maintained throughout the disclosure period and through into the new corporation (Figure 1).

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<sup>266</sup> In February 2017, three GyM main board directors resigned (Jose Graña, the company chairman and son of one of its founders, Chief Executive Mario Alvarado; and director Hernando Graña), and in December 2017, a different three directors were arrested (José Graña, Hernando Graña Acuña and Gonzalo Ferraro, a former CEO of GyM), along with directors of two other construction companies Fernando Camet (president of JJ Camet) and Fernando Castillo (managing director of ICCGSA)

**Figure 1: Graña y Montero’s level of compliance puts it amongst the best in Peru**



Of particular note is the very high level of compliance with constitutive rules, but given Lava Jato, I will focus on the role of INEDs in GyM’s governance because these third parties carry the expectation that they will keep corporations ‘honest’.

From 2013 to 2017 GyM maintained a board of eight or nine directors, slightly above the average for BVL listed corporations with a majority of INEDs in the years 2014, 2015 and following restructuring in late 2017.

Table 2: GyM board membership

<b>Directors</b>	<b>Status</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016*</b>	<b>2017 Jan-Mar</b>	<b>2017 Apr-Dec</b>
Jose Graña Miró Quesada**	President to 2017	Since '96 Pres	ditto	ditto	ditto	ditto	-
Hernando Graña Acuña**	Dir	Since '96	ditto	ditto	ditto	ditto	-
Mario Alvarado Pflucker*	Dir/CEO	2013	ditto	ditto	ditto	ditto	-
Carlos Montero Graña	Ext VP	Since '96 VP	ditto	ditto	ditto	ditto	ditto
José Chlimper Ackerman	INED	Since '06	ditto	ditto	-	-	-
Hugo Santa María Guzmán	INED	Since '11	ditto	ditto	ditto	ditto	-

José Antonio Colomer Guiu	Indep	Since '09	-	-	-	-	-
Luis Miró Quesada Valega	Ext	Since '11	-	-	-	-	-
Federico Cúmeo de la Piedra	INED		App 2014	ditto	ditto	ditto	-
Pedro Pablo Errázuriz Domínguez	INED		App 2014 Ex Chil M'ster	ditto	ditto	ditto	ditto
Mark Hoffman Rosas	INED		App2014	ditto	ditto	ditto	-
Augusto Baertl Montori	President post 2017	-	-	-	-	-	App2017 app Pres
Roberto Abusada Salah	Dir	Since '98	-	-	-	-	App '17
Alfonso Garcia Miró Peschiera	Dir	-	-	-	-	-	App '17
Alfonso de Orbegoso Baraybar	INED	-	-	-	-	-	App '17
Manuel del Río Jiménez	INED	-	-	-	-	-	App '17
José Antonio Rosas Dulanto	INED	-	-	-	-	-	App '17
Rafael Venegas Vidaurre	INED	-	-	-	-	-	App '17
<b>Total</b>		<b>9</b>	<b>9</b>	<b>9</b>	<b>8</b>	<b>8</b>	<b>9</b>
<b>INED/Director</b>		<b>3/9</b>	<b>5/9</b>	<b>5/9</b>	<b>4/9</b>	<b>4/8</b>	<b>7/9</b>

Source:

NB.\* indicates three directors fired in Feb 2017, \*\* indicates two subsequently arrested in Dec 2017

The firm already had two INEDs before the launch of the code and from 2014 to 2017 generally exceeded the minimum recommended level of INEDs as a proportion of the total directorate. One of the INEDs had been long-serving since 2006, and completed a 9-year term in 2015, and a new INED appointed in 2017 had previously served on the board in 1996 but these are not problematic in themselves. However, it seems to have taken GyM a couple of years to really integrate the INEDs in governance.

To explore this more deeply, I make a close inspection of the board committee structures as they evolved between 2014 and 2017 because it suggests that the INEDs were not fully functional during 2014 and that there was a presentational dimension to the changes that were made. In 2014 and 2015, GyM had a relatively large complement of committees with seven in operation.

**Table 3: GyM executive committees controlled by the President in 2014/15**

Directors	Board Committees 2014 & 2015							
	Stat	Audit	HR & Soc Res	Invest and risk	Eng. & Const	Infrast..	Bldgs	Services
		5	6	3	12	12	12	12
Jose Graña Miró Quesada**	Pres			Pres	Pres	Pres	Pres	Pres
Hernando Graña Acuña**	Dir				Memb	Memb		
Mario Alvarado Pflucker*	CEO Dir				Memb	Memb	Memb	Memb
Carlos Montero Graña	VP Ext				Memb			Memb
José Chlimper Ackerman	INED	Pres	Pres		Memb			
Hugo Santa María Guzmán	INED	Memb		Memb		Memb		
Federico Cúmeo de la Piedra	INED	Memb	Memb					Memb
Pedro Pablo Errázuriz Domínguez	INED			Memb		Memb		
Mark Hoffman Rosas	INED		Memb				Memb	
<b>Members</b>	-	<b>3</b>	<b>3</b>	<b>3</b>	<b>5</b>	<b>5</b>	<b>3</b>	<b>3</b>

Source: GyM 2014: 45-57, 2015: 15-20

The committee titles appear to be very operational in their orientation, especially the longer established ones which are in fact the sub-boards for the operating divisions of the company which are held in tight control by the President. These are effectively Executive Committees. Regarding the ‘corporate’ level committees, the Audit Committee had only been established for 5 years, in 2009, and there is no reference to Sustainability, the Environment, Compliance, Governance or similar committees that are evident in other firms. This suggests to me that the board has a very operational perhaps managerial role in directing the business. This view is reinforced by the size of the committees which are mostly small with just 3 members (average membership of 3.6) and each INED attends an average of 2.6 committees, indicating of a practical and focussed agenda rather than of a problem-solving committee with a complex brief. In addition to their focus and scale, the committees are tightly controlled - five of the seven committees, Investment and Risk, Engineering, Infrastructure,

Buildings and Services, are presided by the company President and controlling shareholder and the remaining two, Audit and Human Resources, & Social Responsibility by the relatively long serving non-executive director. This suggests a high degree of control is being exercised by a small group and although the presentation of the committee structure to the SMV appears to comply it does not comply with the spirit of the constitutive rules since most of the committees have an executive focus.

GyM began to make changes to its committee structures in 2016 by dispersing the presidential roles away from the company President, although he maintained membership of those same committees, and involving the CEO, who incidentally resigned with the president over the Lava Jato scandal and an INED (Table ).

**Table 4: Three chairs but the CEO controlling executive committees 2016/2017**

Directors	Board Committees 2016 and first 3 months of 2017							
	Stat	Audit	HR & Sust.	Investment and risk	Eng. & Const	Infrast.	Bldgs	Services
		5	4	3	12	12	12	12
Jose Graña Miró Quesada**	President			Pres	Memb	Memb	Memb	Memb
Hernando Graña Acuña**	Dir				Memb	Memb		
Mario Alvarado Pflucker*	CEO Dir				Pres	Pres	Pres	Pres
Carlos Montero Graña	VP Ext				Memb 2017			Memb
Hugo Santa María Guzmán	INED	Memb		Memb		Memb		
Federico Cúmeo de la Piedra	INED	Pres	Memb					Memb
Pedro Pablo Errázuriz Domínguez	INED		Pres	Memb	Memb 2016	Memb		
Mark Hoffman Rosas	INED	Memb	Memb				Memb	
<b>Members</b>		<b>3</b>	<b>3</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>3</b>	<b>3</b>

Source: GyM 2016: 15 – 17, 2017: 105 – 109

These changes seem somewhat cosmetic. It is difficult to believe that if the company President relinquishes the presidencies of four executive committees presiding over the firms divisions and passes them to the CEO but still comes to the meeting, that much will have changed about the running of that meeting or of the underlying business. The committees are still small with an average membership of 3.4 but the committees per INED has increased to 3.3.

By 2017, two of the three directors indicted over Lava Jato have left the company and the Board, so the company Presidency has changed hands, and further changes have been made to the board committees.

**Table 5: More INED involvement but with the President controlling the business 2017**

Directors	Board Committees Last 9 months of 2017								
	Stat	Audit	HR	Invest- ment	Risk Comp. & Sustainab	Eng. & Const	Infrast.	Bldgs	Services
Carlos Montero Graña	Ext							Memb	
Augusto Baertl Montori	Presid ent			Memb	Memb	Pres	Pres	Pres	Pres
Roberto Abusada Salah	Dir					Memb		Memb	
Alfonso Garcia Miró Peschiera	Dir			Memb		Memb	Memb	Memb	
Pedro Pablo Errázuriz Domínguez	INED		Memb		Memb				
Alfonso de Orbegoso Baraybar	INED	Memb	Memb		Memb	Memb	Memb		Memb
Manuel del Río Jiménez	INED	Memb		Memb	Memb				Memb
José Antonio Rosas Dulanto	INED	Memb		Pres			Memb	Memb	
Rafael Venegas Vidaurre	INED	Pres	Pres		Pres	Memb	Memb		
<b>Members</b>	-	4	3	4	5	5	5	5	3

Source: GyM 2017: 105 – 109

First, a new committee was formed to emphasise Sustainability and Compliance. This was achieved by spitting Investment and Risk into two, to leave a self- standing Investment Committee, and adding to Risk, the Sustainability agenda and a new Compliance agenda. Compliance is now a board issue and Sustainability is reframed away from its association with HR.

Second, the committee memberships are slightly larger with an average membership of 4.3.

Third, the involvement of INEDs in committees has increased – the number of committees per INED has increased to 4.2, and four of the newer committees are presided by INEDs. However, the old operational committees have reverted to being presided by the new company President.

GyM also made other changes to its governance processes during this period. The firm already had an ethics policy and a code of conduct in place in 2013, before the launch of the code. They introduced a whistle-blower channel in 2014, and in 2015 established internal board appraisals and involved the INEDs in discussions of strategy. These developments accelerated in 2017 with a major focus in the annual report on corporate governance. The new board and committee structure was supplemented by changes to the management team, the establishment of an external advisory council and Anti-corruption training for the board and senior management. These initiatives accelerated through 2018 and 2019 as the company sought desperately to distance itself from the substance of the corruption case. In the 2019 annual report, the company listed a further 25 initiatives, 17 of which were constitutive in nature.

GyM was routinely garlanded for its excellent governance: in 2014, GyM was recognised as part of the BVL IBGC, was a recipient of the Key to the BVL, was elected as a

Member of the Companies Circle to draft a paper on Corporate Governance and was elected President of the Board. In 2015, the firm was awarded a Prize for leadership in corporate governance – the *Premio a la Empresa Líder en Gobierno Corporativo*, awarded by the institution ALAS 20 and won the prize for the best corporate governance in Latin America in the construction sector provided by the specialist Journal “Ethical Boardroom”. In 2016 it participated in the Companies Circle meeting in Sao Paulo. But this activity stopped abruptly with the disclosures in 2017.

### **Judgement on Weight of Evidence for pairs of hypotheses**

On the first paired comparison, *Efficiency and Power*, the bulk of the highlighted evidence might seem plausible in the world of the Efficiency hypothesis because GyM keep their board structures tight and well organised but given GyM’s overall level of compliance, it is difficult to believe that it arrived at this position from scrutinizing the costs of governance processes, and the pursuit of outside endorsements would not be driven by cost efficiency arguments. On balance the evidence is therefore rather implausible in the world of economic efficiency. In the world of the Power hypothesis, the strong role played by the President over the board committees might suggest GyM are following the letter but not the spirit of the code and so very plausible as a Power play. However, it is important to note that Presidential control is maintained over the *operational* committees and the INEDs are progressively introduced to the business and gradually given control of the new committees looking at Sustainability, Compliance and Risk, and this split makes a great deal of sense in an infrastructure business where margins are tight, and errors can be very costly. Also, it is not clear to what extent the Lava Jato bribery was known on the board beyond the two directors indicted, but in any case, the bribery was over in 2015, and so it is reasonable to take GyM’s desire to show good governance on its merits. I do not therefore consider that the gradual introduction of INEDs to be window dressing and that the ‘power’ aspect of this



governance process is directed operationally and not towards the code per se, and so I conclude that this is neutral. I therefore rate the Weight of Evidence to be clearly in favour of the  $H_P$  over  $H_E$ <sup>267</sup>, because of the lower plausibility of the evidence under  $H_E$ , as 15dB to reflect the clear difference between the likelihoods.

On the second paired comparison, *Legitimacy and Power*, the highlighted evidence of the pursuit of awards and engagement with bodies responsible for corporate governance in the region are very plausible in the world of the Legitimacy hypothesis. It would be natural for a firm with high compliance and good governance to wish to publicise this reputation and it would seem to be reasonable that in the infrastructure sector, where projects must be won competitively, that a reputation for governance would facilitate Judgement Validators to promote an impression of GyM as a good project manager and therefore as a reliable infrastructure partner. The board structure and committee evidence is again quite plausible in the world of Legitimacy seeking given the apparent need to introduce INEDs slowly. In the world of the Power hypothesis, the evidence is also plausible, but if the firm has high compliance with the code, there appears to be no element of fakery in pursuing outside approbation, it would be more plausible if GyM’s compliance had been low, so the evidence is only somewhat plausible or even neutral. I therefore rate the Weight of Evidence in favour of  $H_L$ <sup>268</sup> over  $H_P$  as 10Db to reflect a clear difference between the likelihoods.

I summarize these judgements here.

**Table 5: Weight of Evidence for GyM favours legitimacy-seeking**

Likelihood	Evaluation	Likelihood Ratio	Evaluation	Weight of Evidence dB		
				$H_E$	$H_P^*$	$H_L$
<b>Efficiency versus Power</b>						

<sup>267</sup> Denoted  $\log[P(EGM|H_E)/P(EGM|H_P)]$

<sup>268</sup> Denoted  $\log[P(EGM|H_L)/P(EGM|H_P)]$

P(EGM HE)	Very Implausible	$\frac{P(\text{EGM} \text{HE})}{P(\text{EGM} \text{HP})}$	Clearly in favour of HP	-15	0	-
P(EGM HP)	Neutral					
<b>Legitimacy versus Power</b>						
P(EGM HL)	Plausible	$\frac{P(\text{EGM} \text{HL})}{P(\text{EGM} \text{HP})}$	Clearly in favour of HL	-	0	10
P(EGM HP)	Neutral					
<b>Total Weight of Evidence from Graña y Montero</b>				<b>-15</b>	<b>0</b>	<b>10</b>

\*NB. Note HP is used as the base case in each pairwise comparison

My conclusion is in favour of the legitimacy hypothesis for GyM with reservation.

