Discussion of “The ‘CorE’ Dynamics of Corporate Soft-Regulation: Theory and Evidence” by Álvaro Bustos and Eduardo Walker

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Summary of the Paper

Big picture. What determines firms' level of compliance of corporate practices?

- More than just regulation!
  - $\rightarrow$ efficiency, scandal risks, marketing, etc

Goal: build and test tractable model that describes firm-level compliance of corporate governance practices and its dynamics

- model predicts level and speed of convergence increasing in initial level, efectiveness and cost of a value destroying event (e.g. scandal)
- model does not necessarily converge to full adoption
- consistent with firm-level data from Chile

Overview of the Model

Two periods (pre-regulation and regulation), two channels (rational, institutional)

- **Pre-regulation.** Firms i perceive utility u^p from adopting corporate practice $p \in \{1, \dots, P\}$ at cost $c_i^p \sim U(0,1)$
  - $\rightarrow$ Firms adopt p if $u^p > c_i$ and thus share adopting is $a_0^p = u^p$

- **Regulation.** Same logic as above, but now investor premium a_{t-1}^p, cost of 'value destroying event' $L^p a_{t-1}^p$ and probabilities of that event $1 - a_*^p$ (adopters) and $1 - a_{t-1}^p$ (non adopters).

$$a_t^p = \underbrace{a_{t-1}^p}_{\substack{\text{previous period}\\ \text{compliers}}} + \underbrace{L^p a_{t-1}^p (a_*^p - a_{t-1}^p)}_{\text{new compliers}}$$

$\rightarrow$ **Speed of converge.** $\frac{a_t^p - a_{t-1}^p}{a_{t-1}^p} = L^p (a_*^p - a_{t-1}^p)$

Main takeaways from the model

Under certain conditions (L^p not too big), the model predicts that:

1. heterogeneity in 'long-run' compliance across practices (i.e. a_*^p not constant in p).
2. Compliance increasing in time $a_t^p \geq a_{t-1}^p$.
3. Compliance is greater for greater a_0, L^p and a_*^p.
4. Speed of convergence decreasing in time and initial compliance.

General Comments

- Why rational and institutional channels are only in one stage of the model?
- Diffusion process dynamics heavily rely in assumption on investor premium (a^p_{t-1})
- Robustness test for presence of institutional channel in pre-regulation depends on the structure of the model
  - $\rightarrow$ What about elements outside the model (e.g. firm age)
  - $\rightarrow$ On a side note, lack of correlation can be due to high measurement error in a_0 (uninformative answers at early stages)

My take

- Very complete paper! theory, empirics, policy implications
- No *one-size-fits-all* compliance policy
  - $\rightarrow$ Policymakers must consider heterogeneity for corporate governance compliance policies
- I think the model can benefit from more general approach.

Minor comments (just for authors)

- Probably a typo in Table 2: "*Board has introduced procedures that will* **reduce** *organization, social and cultural diversity.*"
- I might be useful to note that firms now c_i *ex-ante* in this sentence: "If firm i decides to comply with practice $p \in \{1, \ldots, P\}$ **then** it pays cost c_i^p uniformly distributed in $[0, 1]$