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Corporate Governance

Corporations Are Seeing the Rewards!

"...if companies view the new laws as opportunities - opportunities to improve internal controls, improve the performance of the board, and improve their public reporting - they will ultimately be better run, more transparent and therefore, more attractive to investors."

– William Donaldson, SEC Chairman
July 30, 2003, at the National Press Club

We are now well into the first year of the Sarbanes-Oxley legislated reforms, and it appears that corporations may indeed be receiving some of this benefit.

Reports of corporate restatements, financial scandals and even jail sentences for top executives have forced us to pay a great deal of attention to the reform process set off by the passage of the Sarbanes-Oxley legislation and related rulings. According to a recent McKinsey and Company survey, investors are looking for six characteristics that indicate a well-run corporation: quick extension of governance codes worldwide, increased focus on board professionalism, selective redesign of corporate leadership roles, more extensive external scrutiny of governance, increased attention to corporations' impact on society and reassessment of corporate reporting needs.[1]

Reassessment of corporate reporting is of great importance in capturing the benefits from corporate governance. Two areas deserve serious consideration:

1. Corporations must continue to demonstrate the transparency of their performance through detailed disclosure of results. This is more than just the simple reporting of financial indicators; it requires a detailed explanation of the forces driving operational performance. Business intelligence (BI), business activity monitoring (BAM) and business performance management (BPM) initiatives must encompass these more sophisticated needs and must enable the corporation to communicate and explain its performance to a broader constituency than just the board members. They must allow communication to occur with potential and actual investors, external auditors, and watchdog organizations such as GovernanceMetrics International (GMI) and the Institute for Global Ethics.[2,3]

2. Corporations must rethink what they are actually measuring and reporting upon. According to the McKinsey report, the problem lies in the extent to which financial capital is the only capital that is measured and reported. Traditionally, a company's worth was based on the tangible assets (mostly financial in nature) because these were easily measured and therefore could be reported. More and more though, corporations must deal with intangible items such as goodwill, brand value and intellectual property. The difficulties only start with our ability to measure the value of these assets. How do we actually capture and track this information? What is the yardstick used to determine their value? These questions are just a few that illustrate the complexity created by this requirement.

Clearly, good governance is having a significant impact and benefit. Agencies such as the GMI have attracted the attention of corporations and investors alike because of their corporate governance rating system. The GMI indexes constantly rate a corporation's overall governance profile according to six research categories dealing with various governance codes and principles. A high rating indicates good compliance with governance standards.

The rating becomes critically important because a reported 70 to 80 percent of the investors surveyed by McKinsey stated that they are willing to pay a premium for companies having high governance ratings. This has been borne out domestically and internationally. Premiums are up 14 percent in North America, 25 percent in Asia and Latin America and 30 percent or more in Europe, the Middle East and Asia. U.S. companies scoring high on their compliance practices have gained the investors' premiums, thus outperforming those that have low scores - a significant benefit to these corporations.

Building investors' trust means more than simply complying with the SEC standards; corporations must now actively promote their compliance results to the world. The best method to do this is through corporate reporting mechanisms. DMR

References:

1. "Investor perspectives on corporate governance – a rapidly evolving story," Paul Coombes and Simon Wong, McKinsey and Company 2004.
2. www.gmiratings.com
3. www.globalethics.org

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