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## Gauging Corporate Governance

*(This is an abridged version of the full report which is available for purchase. The 50 page report may be used throughout your company.)*

“Corporate governance is concerned with holding the balance between economic & social goals & between individual & communal goals. . . The aim is to align as nearly as possible the interests of individuals, corporations & society.”

*Sir Adrian Cadbury - Corporate Governance Overview  
1999 World Bank Report*



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## Executive summary

### Gauging corporate governance

*(This is an abridged version of the full report which is available for internal use within your company.)*

***“What shareowners, especially institutional investors, want are understandable measurements, to enable them to judge stewardship, performance, conformance & sustainability on a common basis.”***

King II, 2002

# What is the significance of rating Corporate Governance & which principles govern the rating process?

<i>What is a corporate governance rating?</i>	<i>What assurance is achieved from a corporate governance rating?</i>	<i>Who conducts the corporate governance rating?</i>	<i>Main beneficiaries?</i>	<i>End result</i>	<i>Impact / value</i>
An external, independent opinion assigned to a company on the soundness of corporate governance achieved by that company relative to a best practice benchmark	Assists a company to determine to what extent governance is sound enough to ensure long-term sustainability & to gauge improvements	A multi-faceted, highly experienced external, independent analytical team with the necessary credibility in the eyes of the company as well as outside stakeholders	Shareholders Customers Creditors / Suppliers Employees Regulators General society	Single overall symbol with more than 20 gradations, clear benchmarking, freeform report, clear areas for improvement	Large impact & large managerial value if used as a proactive tool & a discipline

- The Organization for Economic Co-operation & Development (OECD) has articulated broad principles of corporate governance, applicable across most jurisdictions, which are gaining international acceptance as benchmarks
- The guiding principles related to the development of criteria for rating corporate governance are;
  - **fairness**: equal treatment of financial stakeholders, avoidance of fraud, insider dealing, etc.
  - **transparency**: provision of clear & equal access of information to all investors on a regular basis
  - **accountability**: the existence of legitimate systems of control
  - **responsibility**: adherence to the law of the country & stakeholder relations
  - **corporate governance framework**
  - **increased role for shareholders**
  - **minority shareholder protection**
  - **whistleblower protection**

# Typically, *five main components* are considered when rating a company in terms of corporate governance issues

## Components for corporate governance rating

1. **Owner-stakeholders (structure, mandate & rights)**
  - a. Transparency of ownership structure
  - b. Ownership concentration & influence
  - c. Influence of external stakeholders
  - d. Ownership mandate
2. **Board (composition, effectiveness & strategy setting)**
  - a. Structure & independence
  - b. Role, accountabilities & effectiveness
  - c. Strategic implications
3. **Business structuring & execution**
  - a. Owner mandates
  - b. Board directives & strategies
4. **Controlling & monitoring**
  - a. Controlling assets & transactions, delegation of authority
  - b. Monitoring of systems & results, both qualitative & quantitative
5. **Transparency & disclosure**
  - a. Content of public disclosures
  - b. Timing of and access to public disclosures
  - c. Audit process

# Evaluating governance in companies is ultimately a *measurement of the people who govern the company*. The *benefits of corporate governance ratings are many and varied*

- As the rating of corporate governance practices gains broader acceptance, such ratings will become increasingly beneficial to stakeholders

Corporate governance ratings may . . . ;

- enable companies to demonstrate that they strive to be compliant
- be used as an incentive for improvement with regard to corporate governance practices
- provide company stakeholders an independent opinion of the corporate governance strengths & weaknesses pertaining the company & its directors
- enable investors to screen investment opportunities by assessing the degree of governance-related risk
- motivate greater protection of shareholder rights & higher standards of transparency & disclosure
- positively affect a company's valuation where the rating is favourable
- result in greater involvement of independent directors in the governance process
- lead to enhanced public disclosure & understanding about governance risks which may contribute to greater market confidence & resilience
- serve as an early warning for management / stakeholders against management / operational / system weaknesses

. . . while helping to avert the consequences of inadequate or corrupt governance, such as;

- lack of market confidence
- reluctance by investors to invest in companies in certain markets
- investors may require a premium to mitigate the uncertainty where they are unable to evaluate the risk
- shares may be traded at an amount significantly lower than their potential value in some economies
- equities may not be assessed accurately, raising the cost of capital

# The debate surrounding corporate governance is gaining prominence & has become an important risk consideration for investors, non-financial stakeholders, & policy makers . . .

## Risk: Corporate governance as a stand-alone risk factor

- The rating of a company's corporate governance practices has become an imperative function to provide a company & all its stakeholders an independent assessment of such practices, for essentially two reasons;
  1. there has been increasing interest in corporate governance & its role in the global economy in recent years;
    - ❖ in developed markets, corporate governance is increasingly considered a stand-alone risk factor, particularly in the wake of governance related problems & corporate failures within companies worldwide
    - ❖ in emerging markets, many economists have attributed recent financial crises to weaknesses in corporate governance practices
    - ❖ corporate governance practices of companies are under more regular public scrutiny
    - ❖ shareholder activists, investors & financial analysts are increasingly using corporate governance practices as points of differentiation between investment options
  2. the investment decision-making process has become more inclusive of a company's qualitative aspects;
    - ❖ the analysis, assessment & rating of corporate governance as a risk factor has resulted from the need for investors & stakeholders to be informed about the aspects of corporate governance within companies, prior to making investment decisions

## **. . . increasingly, the international community has emphasized the need for global benchmarks against which to rate corporate governance practices**

### **Rating: Global benchmarks for corporate governance**

- Increasing awareness of corporate governance has emphasized the need for global benchmarks against which to measure corporate governance practices, even though legal & regulatory requirements remain regional;
  - stock exchanges & regulators worldwide are looking to establish global standards or codes of best practice for corporate governance
  - since the late 1990's, increasing efforts have been made to build a general corporate governance global framework e.g.;
    - ❖ codes of governance best practice have been developed in many countries (e.g. King II, Cadbury Report, UK Combined Code, Peters Report, Preda Report)
    - ❖ efforts have been made in markets around the world to legislate & regulate corporate governance standards (e.g. Sarbanes-Oxley legislation)
    - ❖ in the late 1990's, the Organization of Economic Cooperation & Development (OECD) developed corporate governance guidelines in an attempt to create a general framework relevant over a wide range of jurisdictions. These principles are revised & updated regularly.
- Rating has to consider a company at country & global level. The jurisdiction & governance practices in every country where a company operates may have an impact on the company's corporate governance rating;
  - a global benchmark will assist shareholders, managers, directors or other stakeholders to objectively assess & compare the corporate governance practices between companies in different countries to address differences

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