

Corporate Governance: Good practice is rewarded

By Paul A Zaman MBA, MSC



Paul A. Zaman takes you from outer space to the linguistics of Corporate Governance for insight.

Professor Bob Garrett, from the UK was in Singapore to share with fellow directors his thoughts on corporate governance. Very interesting especially as Gordon Brown, the Chancellor of the Exchequer in the UK, had done amazing gyrations in 2006 to the bewilderment of British captains of industry as he cancelled the long expected "triple bottom line." . The Chancellor decided not to present the Bill to Parliament for discussion, voting and eventually making it part of the law governing companies.

The triple bottom line is not a club sandwich but very serious stuff. It is about reporting the strategy and operational performance on the three dimensions of the financial, stakeholder and environmental performance of the company. The company selects the most important and key issues to be in the triple bottom line report. This is usually published for the annual general meeting. The financial statement being in the standard annual report and the stakeholder and environment aspects in sustainability report. All have historic reporting on operational parameters and strategy statements on how to improve performance.

The stakeholders include the owners plus banks, employees, suppliers, customers and other key people closely involved. Issues include quantifying equal opportunities and usage of labour in undeveloped countries both directly and via suppliers. The community and environment dimension covers areas like usage of fossil fuel used versus reusable energy; carbon dioxide emissions; physical resources used and how much is recycled by the company; and action plan for pollutants generated.

Corporate sustainability, corporate social responsibility, global reporting initiative and triple bottom line reporting are names for roughly the same thing — they are all about a company reporting about its financials, stakeholder interests and the broader environmental impact of the business. For five years British industry, like its counterpart in Europe, had been working towards implementing the triple bottom line. They were largely ready, willing and able to do it. So it was a great surprise when the government dropped it. The pragmatic British Institute of Directors announced they

would continue to advocate voluntary triple bottom line reporting in line with global trends.

Prof Garret gave an insightful lesson about the linguistic root of governance. The origin of governance is from the Greek word *kubernetes* meaning the steersman and cybernetics — the system. Governance is the melding of setting direction and having a system to monitor and provide feedback so that direction can be maintained.

HITTING A DISTANT TARGET

A good analogy is NASA's Apollo moon rocket. The distant landing target on the moon is known, yet, by design, Apollo spends most of its time off track, as the thrust jets are continually tweaking its direction. Yaw to one side, thruster correction, on track, overshoot and yaw to the opposite side, seesawing to and fro. Apollo spends most of its time off track but within a very tight control range. So, to relate this to the boardroom, governance is about the board setting a precise direction and monitoring the business and tweaking it so that it stays on track, delivering the long-term investment returns for the shareholders. Here is the concern; most listed companies have over half their shares change hands each year. How then does a board know what the long term interests of the shareholder are when they are transient, fickle and often unsophisticated?

The Australian Institute of Company Directors (AICD) is against the triple bottom line, singing the old song of Australia being too small and unique to adopt such global policy trends. Although they do make some good points, such as asking who exactly are stakeholders and is it legal to look after an interest group over the company's owners — the shareholders. A strict interpretation of the Company's Act would suggest the owners' — that is the shareholders' — interests should come first. So a director who focuses on stakeholder groups; employees, customers, suppliers or charities, could breach the law.



AICD also raised the point that mandating the triple bottom line may mean it becomes a process compliance check list, rather than a guide line for governance. They argue that many Australian companies already have environmental strategies and comply with the body of law on environmental protection. Further corporation law mandating the triple bottom line is therefore unnecessary.

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GOVERNANCE AND TRANSPARENCY

Prof Garrett provided us with some food for thought when he spoke on governance and transparency. Countries such as Singapore and Australia do very well on this scorecard, whereas many third world and developing countries do very badly.

Behind governance and transparency is the trust investors have in the board. Trust can be defined as a consistency of values and behaviors in specific situations and contexts. Trust is often a misused word and generalized in terms of values, behaviors and context, which means that individuals are apt to break trust through no fault or error of their own. The only way to have a shared understanding of trust is by a track record and dialogue on the three elements of values, behaviors and context.

The key values needed in governance are honesty and openness. Therefore, fundamental values of good governance for companies with minority shareholders include the following: accountability to majority and minority owners; probity (a beautiful old English word which auditors love to use) which means honesty with wisdom and transparency, meaning openness to all the owners.

This, in turn, provides for two systemic outcomes that benefit the shareholders in terms of lower risk and better investment returns. The internal perspective means improved operational performance, like Apollo landing on the moon exactly as planned. The external perspective gives a lower cost of capital — that is lower interest rates and better terms for raising debt and, also, often a high quality group of sophisticated equity investors. Pension funds are increasingly active in voting on governance issues and rewarding a company with good governance by being a long-term investor.

THE KEY POINT IS...

With corporate governance we must also ask the question: Who are we being transparent for?

Ticking a compliance list of key processes, to say that the annual report has disclosure against a prescribed list of items, largely misses the point. The key point is, Are the shareholders getting the level of ongoing disclosure that they need to support their ongoing investment decisions in the company? Some investors are transient while others are major global unit trusts and pension funds with a wealth of investment experience and hence corporate governance experience. Surely then, the sensible pragmatic measure of corporate governance and transparency is to watch what institutional investors are doing with their money.

There have been many studies of institutional investors and fund managers focusing on the correlation between a company's equity market value and good corporate governance. The findings indicate that companies with good corporate governance are rewarded with around a 20 percent increase in value compared to those with inferior governance. In the emerging equity markets, this premium for good governance can be much higher. On the other hand, there is equally likely to be evidence that suggests that opaqueness does not necessarily mean that there is corporate mis-governance.

So how then should we interpret corporate governance awards based upon a tick the box approach? Simply who cares?

Qualvin Advisory was founded in 2003. We provide advisory services to the Board, CEO and CFO of listed and unlisted companies in S.E.Asia. Qualvin facilitates the Board in areas such as formulating corporate goals & strategy and governance & CSR. Qualvin also formulates and executes the financial investor relations strategy to: increase shareholder value and institutional following; firm the share price and raise new capital. Contact Paul Zaman at Email pzaman@qualvin.com.