Center for International Private Enterprise

BUSINESS JOURNALISM AND CORPORATE GOVERNANCE

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WHO, WHAT, WHY, WHEN AND HOW….AND SO WHAT? CORPORATE GOVERNANCE REPORTING

As media practitioners, you will already know the essential elements of writing a story. But perhaps the most important issue is the ‘so what’ angle. In other words, ‘so what’ is important about this story? ‘So what’ makes it news? ‘So what’ does it mean to shareholders?

The answer(s) to the ‘so what’ question will inevitably be the crux of your story. Keep that in mind at all times. In this guideline, we will attempt to highlight the need for reporting on corporate governance, how it can contribute to the development of any society, and how to go about developing your skills as writers on the subject.

The media can play an essential role: it educates the wider public about corporate governance, its role and benefits, and more importantly, it can complement the activities of regulators in applauding strong compliance and exposing abuses.

Furthermore, stories with a corporate governance angle are interesting, intriguing, full of color and strong personalities, and can change lives, companies, and even countries. They are exciting to investigate, and they can make journalists famous.

Elements of a Good Story

It is essential that every corporate governance story includes the basic elements of good journalism:

- **Factual and accurate information**
- **Credible sources**
- **Jargon-free language**
- **Balance and fairness**
- **Time frame**
- **Context & background**
- **Implications & relevance**
- **The ‘so what’ angle**

Reporting on Corporate Governance

Good corporate governance benefits everyone in society. It reduces supply-side corruption by demanding transparency and accountability for financial resources. Corruption limits sustainable investment, and it perpetuates a criminal mentality amongst those who pay bribes, and those who solicit them.

A strong governance ethic, on the other hand, attracts investment from local and foreign investors by providing a strong underpin for the protection of property rights, which is at the heart of corporate governance. Increased investment in the private sector in turn promotes economic advancement, which is essential to tackle the many social problems found around the world, including the Middle East.

Before embarking on any corporate governance reporting, it is important to understand the difference between **management** and **governance**. **Management** deals with daily operations, while **governance** is about the underlying ethics of a corporation. Poor management can affect governance, and weak governance will ultimately undermine the financial and operational performance of a corporation, and affect investors' faith in management.

One of the most obvious themes for any journalist to pursue is how compliance (or the lack thereof) with governance principles affects the performance and reputations of individual organizations, and individuals within those organizations. A spectacular failure by one company can trigger a crisis of confidence in an entire sector, economy or even country.

Similarly, companies that adopt a recognized code of corporate governance are far more likely to benefit from greater access to capital, improved employer-employee relations, constructive feedback from the investment community, and a generally higher reputation score. Occasionally, some of these factors (reputation management, employee relations etc) are treated by unenlightened management as 'soft' issues versus hard issues (capital, financial management and performance, share price and so on). However, 'soft' issues have as much of, if not a greater, impact on the financial performance of companies as the financial 'nuts and bolts'.

Why is Corporate Governance Important?

Corporate governance has become a major issue for businesses in an increasingly global economy. While good governance is no guarantee of any company's financial success, its absence inevitably has widespread negative consequences.

At its most basic level, corporate governance deals with issues arising from the separation of ownership and control, by providing a set of rules that protects the interests of the shareholders, while not neglecting all the other stakeholders that have a vested interest in an organization. In small and medium sized enterprises (SMEs) or family-owned firms, these principles still apply, and should be adopted to enhance efficiency, minimize conflict, and ensure the transition of ownership from parent to heir.

The OECD Core Principles

1. The Rights of Shareholders and Key Ownership Structures
2. The Equitable Treatment of Shareholders
3. The Role of Stakeholders in Corporate Governance
4. Disclosure and Transparency
5. The Responsibilities of the Board

The basic model creates a set of rules and procedures to ensure:

- shareholders elect directors who represent them;
- directors vote on key matters and adopt the majority decision;
- decisions are made in a transparent manner so that shareholders and others can hold directors accountable;
- the company adopts accounting standards to generate the information necessary for directors, investors and other stakeholders to make decisions; and
- the company's policies and practices adhere to applicable national, state and local laws.

A framework of good corporate governance includes:

- **internal controls**, which minimize risk by promoting transparency and defining the relationship between managers, shareholders, boards of directors and stakeholders; and
- **external controls**, which comprise the legal and regulatory framework supporting the principles of corporate governance.

Benefits of Corporate Governance

Empirical research conducted has revealed that over 84% of global institutional investors will pay a premium for the shares of a well-governed company over one considered poorly-governed but with a comparable financial record.

Strong corporate governance:

- improves access to capital and financial markets;
- establishes a system of internal controls that promote greater accountability and better profit margins;
- helps companies survive in an increasingly competitive environment through mergers, acquisitions, partnerships, and risk management;
- strengthens management by shaping a sound company strategy that will attract investment;
- creates standards for transparency in dealing with investors and creditors;
- helps prevent systemic banking crises even in countries where most firms are not actively traded on stock exchanges;
- protects minority shareholders and their investments;
- makes corruption difficult; and
- ensures a smooth inter-generational transfer of wealth and divestment of family assets, as well as reducing the chance for conflicts of interest to arise.

Weak or absent corporate governance:

- makes it hard to attract sufficient capital, erodes competitiveness and limits job creation – it can ultimate put a company out of business;
- allows insiders (company managers and directors) to ransack companies at the expense of shareholders, creditors and other stakeholders; and
- may force authorities to enforce compliance, leading to excessive regulation that stifles private sector growth.

The Role of the Media

A vigorous and informed media is essential in helping small investors and other affected stakeholders make informed decisions about corporations. It is also a fundamental element of a democratic society.

To be effective in reporting on governance issues, reporters can draw up a list of criteria for strong compliance:

Are the directors' interests sufficiently aligned with, and dedicated to, creating long-term value for the company?

- Do any board members have conflicting interests that may prevent them from effectively representing all shareholders?
- Do any directors represent government or a union?
- Does a major shareholder control the board?
- Are board elections staggered or are all directors elected at the same time?

Does the compensation of directors encourage them to act in shareholders' interests?

- Are directors so dependent on the cash compensation that they cannot take responsible action on behalf of shareholders?
- Are they paid even if they don't attend meetings?
- Is there a committee to decide director remuneration and is the information made public?
- What are the bonuses and share option schemes?

Do the directors have ownership positions that positively align their interests with shareholders' interests?

- What percentage of shares do they own?
- Are there independent directors who do not hold any shares?

Is the chairman of the board independent?

- Is the chairman a strong enough personality to stand up to the chief executive?
- How many other boards does he sit on?

Does the corporation provide appropriate reporting?

- Are reports provided in an accessible and timely manner to the authorities and shareholders?

Are the reports accurate?

- Do they disclose proposed changes in structure of corporate policy?
- Are the accounts in international accounting standards (IAS) or local standards, which tend to hide information in general categories?
- Are they verified by reputable auditors?

Are the reports adequate?

- Do they give investors sufficient information to make informed investment decisions?
- Do they provide information about the real issues?

How easy is it for shareholders to participate?

- Are there obstacles to voting?
- Are there legal barriers, such as the need to notarize a proxy or inability to mail in proxies?
- Are there artificial barriers such as holding meetings in obscure, distant places at inconvenient times?
- How is the notice of meeting delivered? In a legal advertisement published in an official bulletin that no one reads, or sent by mail and/or published in a popular newspaper?

Can shareholders initiate actions?

- What percentage ownership is required to call shareholders' meetings?
- Is the shareholders list available to others or is it a "business secret"?
- Are there groups that represent minority shareholders?

What is the company's attitude toward shareholders?

- Are they viewed as a bothersome necessity?
- Is the company open to active participation?
- Can the corporate statutes be accessed by all shareholders?

Writing about companies

We have already considered how the answer to the 'so what' question will shape your article. But before you get to that point, you need to understand your sector beat and its role within the wide national and macro economies.

Think of a company with poor corporate governance as a human being with some unknown illness. Like a doctor, you can see some of the symptoms but you need to diagnose the root cause. Poor profits and a weak share price are some of the physical symptoms – the key is to find out what is causing the problem.

Just like a doctor would enquire about the behavior of his patient and his environment to diagnose his ailment, so too do journalists need to consider the context in which the companies they are following operate:

For example:

- what is the company's performance and profit record?
- what is the trading pattern of the shares?
- is the stock exchange vigilant about corporate governance?
- has the company been through corporate actions?
- was it previously state-owned?
- what is the level of foreign direct investment in the country and the company?
- how well do the financial markets perform?

Just as a doctor does basic check-ups on blood pressure, weight, and heart rate, journalists can look at the basics to get a sense of the overall well-being of any company.

For instance, regular coverage and analysis of financial reports: quarterly, interim (6 months) and annual offer an excellent insight.

Many shareholders rely on journalists to guide them through the financial maze of the quarterly earnings reports. Financial analysts play a role here too – they have sophisticated skills that allow them to formulate conclusions that are useful to journalists in crafting a perspective on a company. Context remains essential – how do the results fare against the comparable reporting period, the rest of the market and with what the market had expected.

Once past the numbers, it is valuable to consider the role of corporate governance in the strategy and performance of a company. In a well-governed, well-managed company, the board of directors is actively involved in setting the strategy of the company and ensuring it is implemented by management. A simple matter like board attendance will give you an indication of how actively involved they are. In addition, if a company has a number of board committees – such as remuneration or audit – the chances are that it is aware of the need to have governance structures in place.

One of the most difficult aspects of implementing good corporate governance is finding qualified directors. For example, many companies in Bahrain want to elect independent directors to their boards to comply with a new Code of Corporate Governance soon to be issued, but there are not enough to meet demand. Elsewhere in the world where economies have experienced the same skills shortage, Institutes of Directors have been established to train directors to be professional and active members of boards. There are prominent Institutes in Egypt, Brazil, the Philippines, Russia, and Pakistan, among other countries. As the value of independent directors grows, the demand for such training will rise and the number of suitably qualified directors will increase.

The Stock Market

An active stock exchange and the regulatory authority play important roles. Seeking a listing on any exchange to raise capital, for example, requires a great degree of transparency and accountability, and companies have to comply with extensive listing requirements.

These include many elements of corporate governance, such as disclosure of financials, protection of shareholders, internal and external audits, and independent directors. Typically, the process of securing a listing requires companies to make significant changes in their management and governance structures, which – while costly in the short-term - are beneficial in the long run.

A regulatory agency, like a Capital Markets Authority, has oversight over listed companies to measure and ensure compliance with the listing requirements. Those companies that fall short of compliance can be fined, sanctioned, suspended from trading, or even de-listed.

Companies not listed on a stock market may be more secretive, and many government-owned entities might not keep or release reliable information. They may also cite national interest and national security for not discussing an organization's performance.

Make sure you know the rules that regulate **insider trading** – this area of illegal activity is often a treasure trove of information on corporate governance. Additionally, share transactions by directors generally have to be published by the stock exchange, following notification by the directors – the reasons why directors are buying or selling can provide excellent material for articles.

Key Questions:

What CG principles are included in the listing requirements? What happens if companies violate listing requirements? Are there sanctions or de-listings?

Mergers and Acquisitions

Mergers and acquisitions have been a high-profile feature of the business landscape for decades. Each transaction is different, and while most are above-board, some have provided great material for corporate governance exposés.

To explore the M&A related corporate governance issues, you might ask:

- Is there a conflict of interest between the two parties?
- How will the corporate activity it affect shareholders?
- Did shareholders have an opportunity to vote on the

decision?
- Were any directors rewarded for playing a role in the deal?
- Are there any anti-competitive issues?
- How will staff, suppliers, customers be affected?

<u>State-Owned Enterprises (SOEs) and Privatization</u>

Corporate governance is not just about the private sector. In many developing, emerging, and transitional economies, public sector companies contribute more to the nation's gross national product, employment, income, and capital use than private sector firms. Moreover, they often shape public policy. As a result, instituting sound corporate governance within public sector companies is essential to economic development, growth and reform.

Public companies need to be corporatized before they can be privatized, and this can be a lengthy process. It takes time before the new company benefits from active owners and skilled managers, yet management needs to ensure that the company's resources are managed efficiently and fairly, with the aim of increasing productivity and value.

Issues to consider:

Labor Impact: What will be the impact of privatization on the workers of state-owned enterprises and what should be done to mitigate any harm? How can workers be encouraged to support privatization?

Laws and Regulations: What is the best legal and regulatory framework to support the government's privatization program? What institutions should be created to carry out privatization?

Methods and Techniques: What are the objectives of privatization and what method of privatization will achieve those objectives? What criteria should be used to determine the best method (share flotation, strategic sale, management-worker buyout, vouchers, etc.)?

Ownership: Who are the new owners and do they have any conflicts of interest?

Key Questions:

Is the public aware of what is happening?
Are the bids truly competitive?
Is there an element of corruption in decisions about which bid wins?

Communication: How well has the process been communicated to all stakeholders?

Competition: Will the privatized entities benefit from having a virtual monopoly as a state-owned enterprise?

Transparent, straightforward and fair rules and procedures for how and when enterprises can be privatized are essential. Poorly managed privatization schemes can devastate an economy and negatively influence the business environment, and the perception of the country in the international investor community.

Foreign Direct Investment: Improvements in the Investment Climate

Foreign direct investment promotes economic growth and creates jobs, introduces new technology and world-class production standards, and improves local skills. FDI is the most common type of capital flowing across borders in both developed and developing economies.

Companies that need foreign investment must comply with corporate governance best practices to provide investors with comfort that their financial investments are safe. Companies that demonstrate solid governance will be more successful in attracting foreign investors, but it should be a voluntary exercise rather than being reluctantly instituted in a crisis.

Media attention paid to corporate governance makes international investors feel more confident about investing in that country when they realize that corporate activity is subjected to vigorous scrutiny.

Financial Markets

Market coverage - writing about bonds, foreign exchange, shares, commodities such as oil and rice, and complex financial instruments – can be intimidating, due to the pace the market moves and the jargon used by traders. But it is an excellent training ground to develop skills for breaking news, and traders often prove excellent sources, as they get to hear about market-moving corporate actions long before they becomes public knowledge. In a global economy, many seemingly unrelated market data are closely connected – so always think about the big picture.

Basics of market coverage:

- Where is the market in terms of trading volume and prices?
- What news is affecting these indexes?
- What is the impact of the weather?
- What external events are influencing trading? (war, elections etc)
- What is the market expecting?

<u>Your biggest asset is your source</u>

Sources are like customers – treat them well, and they'll come back to you again and again. Treat them badly once, and not only will you damage that relationship permanently, but your source will spread the word and you might go out of business.

BUT….always remember, that no source ever gives you information without having an agenda. Knowing that agenda, and understanding what is in it for him to give you confidential information will protect you from being manipulated.

In terms of market regulation, there are very stiff penalties for spreading 'inside' information. Yet journalists rely on this information to break stories. In some countries, possessing inside information without appropriate permission, even though the information is not used in any way, is enough to run the risk of criminal prosecution. Be very careful to whom you speak, and even more careful how you use the information.

Typical sources:

- Company employees can make excellent sources, but in many cases, they know they will easily lose their jobs if they are found out.
- Company analysts are useful for various types of information, but they will seldom say anything really 'negative' as many of their employers offer financial advice and structuring to the same companies at one or other stage.
- Former employees are often prepared to spill the beans, 'dish the dirt' even, but this advice comes with a major warning – such individuals often have an axe to grind, and the information has to be very carefully checked.
- Company advisors – such as investment bankers, lawyers – are often the best source of information – again, they always have an agenda.
- The PR representative can be useful – but they will never jeopardize their fee income by telling you sensitive information that puts the client in a poor light.
- Industry associations are a surprisingly good source of great information as they generally don't tend to have as many vested interests as the rest, and often play the role of industry watchdog – so it is in their best interests that poor governance is exposed.
- Senior management and directors only become good sources after being cultivated over a fairly lengthy period of time – by the stage these individuals reach these positions in management, they have become very cynical about the media and experts at surviving corporate politics – again, they will always have an agenda in talking to you.
- Competitors can also provide useful detail, however, remember they have the most to gain from feeding negative stories about rivals into the market.
- Front-line personnel – secretaries and receptionists know everything that is going on – ALWAYS be respectful. If they take an active dislike to you, they will also block any access to their bosses.

So how do you escape the trap of falling foul of a source's agenda? The answer is simple – never, EVER, rely on only one source of information. Triangulate – in other words, look for at least three sources. Your stories will be immeasurably stronger if you can get your sources to go on the record – information that is not attributed directly diminishes the value of a story.

Always keep your ears open for interesting information about your sources – their favorite sport, whether they have children, their hobbies, and so on. Even the smallest, seemingly irrelevant piece of information could prove invaluable at the right time.

Always make yourself available to speak to your sources: journalists that work according to the clock will never be successful. Many of your sources will be important and extremely busy people who snatch moments in a tight schedule to return your calls – and in many cases this will be outside 'normal' working hours. **A good journalist is on duty all the time.**

Give your source your cell phone number and make sure it is always on.

Do NOT record interviews – it makes people very nervous, and they are far less likely to talk freely if they know they are being recorded.

Social events are often excellent opportunities to get good information from your sources as they tend to be informal and more relaxed.

On the record/off the record

Many companies and journalists have been caught out by not defining or understanding what 'off the record' means. Make sure everyone know exact which version of 'off the record' is being used.

Additionally, a source must always qualify his comments as being off /on the record BEFORE he makes them. Saying so after the fact is not acceptable.

Occasionally your sources will not speak to you unless you promise to send them a copy of the article prior to publication. Many publications have conflicting views on this issue – the most basic being that allowing your sources to see your story prior to publication will give them an opportunity to influence it. This situation can come down to making a choice between your own agenda/personal value set and company policy.

Press Releases

A press release is what the company wants to say - it is not always news, and it is seldom balanced.

Ideally, reporters should break news, and not just print it – this means being one step ahead of the PR department. If you don't get the 'scoop', then do not rely entirely on a press release: Look for additional information to give balance, an angle that will add value to your readers, and that 'so what' element that will make your publication respected. Sometimes a company will omit the most important news element of all, because they have complied with the disclosure requirements to the letter and this did not require them to give out that information. This is where knowledge of the company and sector prove invaluable, as it will allow you to 'read between the lines' and sniff out the really vital information. Often, in situations of crisis, what is NOT said in a company statement is far more important than what is disclosed.

Generally, company spokespeople are helpful, and it is important to develop a good professional relationship with them. They can arrange interviews, make sure you get information quickly, provide important background information and answer questions when top executives are not available. Furthermore, if you develop an excellent relationship with them, they will often give you more than your competitors at other publications – all of which helps in building the 'so what' element. Remember it is in their interests to have a good relationship with you, and they may be willing to take you into their confidence to establish this.

But their first allegiance is to the company, and therefore they may downplay or deny developments taking place or problems in their company. You must reflect their responses, but not necessarily believe them! Furthermore, never take a press release at face value, particularly if the news is not favorable. Triangulate!

Using the Internet

The Internet is both a fantastic and a frustrating resource. It is extremely useful for providing useful background information – the problem is that the authenticity and accuracy of the material is not verified.

Cultivating Relationships with Sources

Initial meetings with sources should be face-to-face.

Follow-up and regular contact are the most important elements in developing sources.

Get ground rules straight with sources. Make sure to agree if you're talking "off the record," or "background only" and be clear what that means.

Be careful with using unnamed sources or attributing anonymously.

Trust with sources is necessary on both sides.

Be honest with yourself if you get the point where you are relying on the same sources and failing to develop new ones.

It never replaces traditional methods of reporting. Facts must still be checked and companies must still be given a right to reply. Data is no more reliable than its source.

Good reporting on business and economic trends can be found on:

- BBC at www.bbc.co.uk
- Business Week at http://www.businessweek.com:
- The Economist at www.economist.com: This offers some articles without a subscription.
- The Financial Times at www.ft.com (partial subscription)
- Reuters at www.reuters.com
- The Wall Street Journal at http://www.wsj.com (subscription only)

The key is keeping informed – the journalist who has a good understanding of his industry and has cultivated a network of excellent sources will get the best stories, particularly if they are energetic and apply lateral thinking.

Economic Indicators

All governments release economic data that provide a quick way to take the pulse of the broader economy. Indicators are typically released by government agencies such as the ministries of investment, trade, planning or industry, by a general statistics office or by the central bank.

Always compare the current figures to the figures from the year before as well as the period before. If the story focuses on the second quarter earnings, you must compare it to second quarter earnings of the year before and to first quarter earnings of the same year.

Simple comparisons may not be enough and may sometimes disguise important details. A country's revenues may not appear to be growing. However, there may be important changes in different sectors of the economy that are not obvious from the overall number.

Always put these numbers in context. How do they compare to recent history? Do they confirm a trend or do they represent a break in an expected trend? If the latter, is this the beginning of a new trend or are these numbers an anomaly?

Define what the indicators are and tell the reader a little bit about what is included in the data. Always avoid jargon, and never assume your readers know what you are talking about.

Corporate Governance Glossary

Independent director: A person who does not depend financially or through familial or business connections on the Chairman of the Board of the company's business.

Non-executive director: A director who is not actively involved in running any aspect of the company.

Staggered Board: Electing each director in a different year so that the entire board cannot be changed at one annual meeting. This prevents a takeover, or at least delays it and makes it more costly.

Proxy: A vote, almost always in writing, which is cast by a substitute in place of the shareholder.

Corporate actions: Usually a motion made by a shareholder, which, if approved by the majority of voting shareholders at the meeting in which the motion is made, causes the corporation to do a specific thing. This could be a change of corporate policy, or the obligation to give employees a certain type of pension.

Capital market: An organized system where ownership rights in corporations (shares or stocks) are bought and sold. Usually called a "stock exchange", the system may have brokers present on a "floor" for hours like some commodity exchanges in the U.S., or it might electronically match buy and sell orders during a one to four hour period.

S.E.C. - Securities and Exchange Commission: A legal body set up by the government to supervise the capital market. It may be part of the Ministry of Finance, the Central Bank, or some other state fiscal institution, or be an independent organization called by some other name, but its purpose is to make certain that the market functions smoothly, and that all investors are treated equally and fairly.

Notice of meeting: To convoke a shareholder or director meeting, formal notice requirements must be met. These requirements are found in corporate laws and the organizing documents of the company. The purpose of the notice is to give shareholders information about what will happen at the meeting, where it will be held and when.