

Business Reporting Beyond Numbers

Looking for the Good, the Bad, and the Ugly in Corporate Governance

Corporate governance practices directly affect strategic management of an enterprise, an increasingly important agent in modern society. This Lessons Learned aims to help business journalists track down corporate governance stories, ask the right questions to uncover critical information, and explain complex subjects to the public.

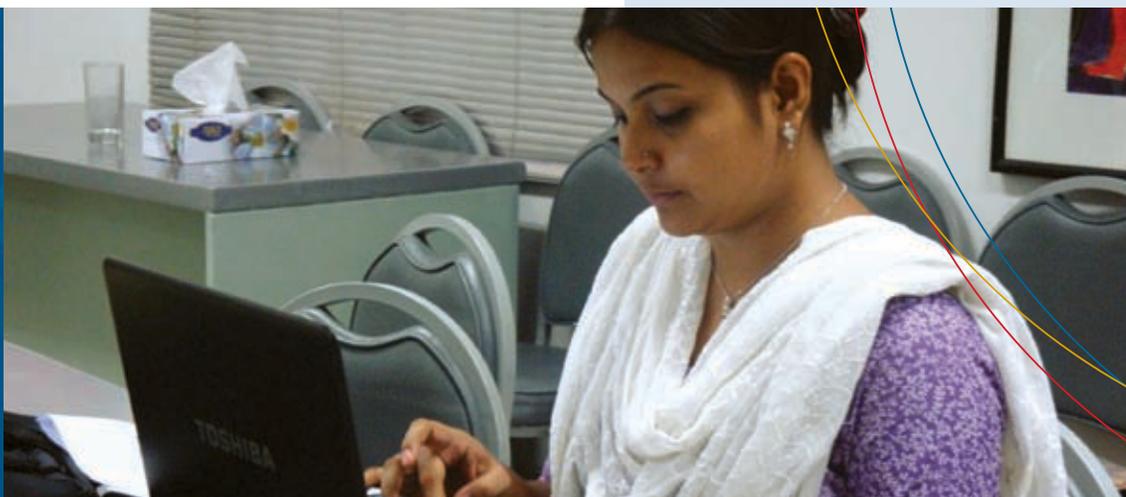


Global
Corporate
Governance
Forum



Lessons Learned

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In mid-December 2008, the India-based information technology company Satyam Computer Services, Ltd. announced plans to acquire two companies owned by family members of Satyam's founder and chairman. After institutional investors strongly protested the purchase, and the stock market hammered the stock's value, the deal was withdrawn quickly. Four "independent" directors subsequently resigned.

These events triggered news stories about Satyam's corporate governance policies and

practices, initially focusing on RPTs (related-party transactions—transactions between two parties who are tied to one another by a prior relationship): Did the board approve the RPTs? Why wasn't shareholder consent sought? Why aren't more details available? Who should be held accountable? Why the sudden resignations?

A month later, new front-page headlines appeared. Satyam's founder, B. Ramalinga Raju, pleaded guilty to vastly inflating the company's assets by exaggerating

Media Training Program on Corporate Governance Reporting

In partnership with Thomson Reuters Foundation, the Forum launched its Media Training Program in 2007. It aims to raise public awareness of corporate governance through the media, improve journalists' investigative skills to probe corporate governance issues, and encourage adoption of good corporate governance practices in emerging markets. In April 2010, AFP Foundation (Agence France Presse) also became a partner.

The participation of both foundations—AFP and Reuters—helps ensure that the journalists' point of view is well-integrated into the program. They also attract experienced international and local trainers. As of mid-2010, the Forum had already held 11 training workshops for journalists, with participants from more than 25 countries. On many workshops, the Forum partners with local offices of IFC Advisory Services.

ABOUT THE FORUM

The Global Corporate Governance Forum is the leading knowledge and capacity building platform dedicated to corporate governance reform in emerging markets and developing countries. The Forum offers a unique collection of expertise, experiences, and solutions to key corporate governance issues from developed and developing countries.

The Forum's mandate is to promote the private sector as an engine of growth, reduce the vulnerability of developing and emerging markets to financial crisis, and provide incentives for corporations to invest and perform efficiently in a transparent, sustainable, and socially responsible manner. In doing so, the Forum partners with international, regional, and local institutions, drawing on its network of global private-sector leaders.

The Forum is a multi-donor trust fund facility located within the IFC, co-founded in 1999 by the World Bank and the Organisation for Economic Co-operation and Development (OECD).



Aleksandar Vasovic, editor and trainer with the Balkan Investigative Reporting Network, uses the training materials at the Forum's Eurasia Media Workshop in Almaty, Kazakhstan, October 2008.

cash balances, booking fake interest, overstating debt, and understating liabilities. Additional charges against him and other company officials included using forged documents, falsifying accounts, and contributing to the disappearance of evidence after investigators' inquiries. Satyam's shares plummeted 77.47 percent on the day that this news broke.

The journalists' focus shifted abruptly from RPTs to something more sinister—allegations of fraud and obstruction of justice. How could the board have allowed India's largest fraud—its "Enron"—to persist for so long? Why weren't the financial shenanigans detected by the accountants, auditors, directors, and senior management in preparing and approving financial reports? Weren't there any red flags? Were whistleblowers silenced? Were the regulators sleeping?

These are the kinds of questions reporters posed in their quest to clearly explain and analyze Satyam's corporate governance failings. The journalists' work was central in helping investors, the government, and stakeholders understand the problems, and then define the reforms needed to prevent future scandals and to avert the company's demise.

This case underscores the growing need worldwide for deeper, more informed reporting about companies' corporate governance policies. Investors seek greater transparency from the companies they invest in, particularly after the 2007–08 global financial crisis revealed high levels of poor risk management, deceptive accounting, and weak accountability for board and senior management decisions. Also, more and more family-owned companies are seeking to go public, which will enable them to attract more capital, often from foreign investors, to survive and grow.

The implication: News organizations must broaden and deepen their reporting on and analysis of corporate governance.

Why Journalists Need To Understand Corporate Governance

Journalists routinely report on the issues that constitute corporate governance, such as conflicts of interest and fraudulent accounting. Yet, the term "corporate governance" is seldom used, barely recognized, and low if not nonexistent on the list of "newsworthy subjects" that reporters tend to pitch to their editors. To properly cover the workings of a modern enterprise, journalists need to understand how it is governed—and how various issues under the corporate governance umbrella fit together and affect the company's performance. A good understanding of corporate governance improves the quality of business reporting, and helps journalists build working relationships with the companies they cover.

"Corporate governance importantly affects firms' access to financing, their cost of capital, valuation, and performance. Better corporate governance leads to higher returns on equity and greater efficiency in firms' operations."

Stijn Claessens

Corporate Governance and Development,
a Forum Focus publication. Available at www.gcgf.org.

According to Roger Jeal, a consultant with Thomson Reuters Foundation, "Corporate governance should be part of journalists' day-to-day work on company news, providing more ideas of where to look for stories. Journalists may be reporting on it even if they don't realize they are doing so. Knowing more about the issues, they can ask better questions."

Why Corporate Governance Needs Journalists

Well-informed reporters and editors play a central role in building awareness of the value of corporate governance. Through their investigations, they can show the consequences that result when companies are poorly governed. They can also illustrate how companies that abide by best practice not only perform better but also are more resilient in economic crises.

If the journalists' credibility is perceived as unimpeachable, their analyses tend to influence opinions of leaders in business, government, academia, and stakeholder communities.

Journalists also pay closer attention to warning signs than do most others. They investigate these red flags and expose problems, fraud, incompetence, and abuses of power. Their work can be a powerful antidote to insufficient or imperfect regulation and legal systems. In discussing journalists, Michael Borden, a Cleveland-Marshall College of Law professor, writes:

First, in their capacity as an investigative watchdog, they can discover and report financial fraud and instigate a market-based response that, in combination with governmental investigations, will put an end to the fraud.

Second, their reporting can uncover wrongful corporate market conduct and, thereby, alert traditional players in the legal system to wrongdoing and set them into action to correct it. In this respect, they are stalking hounds for regulatory enforcement officials and plaintiffs' attorneys. Regulatory investigators will get the scent of the hunt from the journalists and then use their subpoena power to further root out the misbehavior and bring appropriate judicial or administrative proceedings.

Third, by reporting on illegal corporate market conduct, journalists can create a sort of external monitoring and reporting system against which courts can measure the efficacy of internal compliance programs required under state and federal law.

Cristina Sevillano del Aguila, a participant from *Stakeholders Magazine* (Peru), advises journalists: "If you're ignoring corporate governance in your coverage of companies, you are only giving your readers part of the story. For investors, too, they need independent information beyond what companies provide to be effective in rectifying wrongdoing. That information must be written so that it's easy to understand and relevant to your audience's interests."

Where the Corporate Governance Stories Are

Corporate governance stories can be found in a company's financial statements; in the views of shareholders and other stakeholders; in government policies and proposed changes; in board decisions on business strategies, leadership, and operations; and in announcements of plans to buy certain companies, to be acquired, or to sell off divisions, brands, or facilities.

"There are many types of corporate governance stories," says Tamal Bandyopadhyay, Deputy Managing Editor of *Mint*, India's second largest financial daily. "There may be a battle in the boardroom over the chairman having too much power. Shareholders may be angry that the board and senior managers operate with too much secrecy, which is covering up, for

example, special favors for friends and family and other conflicts of interest, such as inappropriate related-party transactions. The company's financial statements may be rigged to hide problems."

"When it comes to corporate fraud scandals, nowhere is safe."

Andrew Marshall
Asia Political Risk Correspondent, Reuters

Likely places to look for corporate governance stories include an organization's board, its finances, and its senior management.

Board Composition: A good starting point is the board's composition, its operation, and its decision-making process. For example, are the chairman and the CEO positions filled by the same person? Best practice advises splitting the roles to curtail one person's dominance of board deliberations and to have two distinct perspectives—the chairman's more strategic viewpoint and the CEO's operational and managerial insights. Advocates for splitting these positions say it minimizes the chances for CEO/chairman entrenchment, excessive CEO compensation, and other corporate ills.

On the other hand, more than 30 studies suggest that the advantages or disadvantages of combining the roles of chairman and CEO vary by organization, with some smaller companies benefiting from the combination; that the person(s) who fill(s) those positions may matter most in determining a company's performance and governance; and that having a board of the appropriate size is also important.

Another area of board composition that can be a source of good story ideas: the individual directors. Questions in this area may reveal much about whose best interests guide a company's actions: *Whom do the directors represent? Any family ties? Are independent directors truly independent?* Such questions may reveal whether there are any conflicts of interest that may compromise integrity, undermine performance, approve wrongful uses of the company's assets, or inappropriately distribute profits.

Board members' independence is a quality that is receiving increasing attention as a means of ensuring impartial decision making. True independence requires not only compliance with the technical definition (for example, not having been employed by the company within a specified period of time, not having received payment from the company exceeding a specified amount, and not representing the controlling stakeholder), but also *independent mindedness*—a truly objective approach to analysis and evaluation.



Participants at the Forum's Media Workshop in Malawi, May 2010.

Financial Statements: According to Adeeb H. Khan, FCA, a partner at KPMG/Rahman, a company's financial statements may offer many red flags to investigate. Khan, who participated in the Bangladesh training session in May 2010, suggests asking the following questions:

- *Is the company using footnotes to hide key information that may be contradictory to the positive spin the board and management want to communicate?*
- *Is the company fairly valuing the assets and liabilities being reported, or are assets inflated and liabilities discounted? Does a comparison of quarterly figures reveal erratic moves in both categories?*
- *How is the company making money? If it is in sales of equipment or services, do the revenues listed represent the reporting period only, or do they include anticipated revenues from subsequent periods?*
- *Are the firm's accountant and auditor qualified, credible, independent, and free of any regulatory or legal problems? The process used to create, verify, and audit the financial statements is a key area to probe for wrongdoing.*

Senior Management: An examination of the board's oversight of senior managers can reveal such red flags as conflicts of interest, a decision-making process that results in bad business decisions, and excessive risk-taking.

The right questions can uncover a great deal of information. For example: *Are there any business or family ties between directors and senior managers? If so, do they create conflicts of interest that create more liabilities than profits? Are management's business plans rubber-stamped by the board? Do board minutes and shareholder annual meetings show rigorous evaluation, constructive debate, and healthy skepticism by the directors toward management's proposals? Are the votes typically unanimous, or is there dissension? Is there a succession plan? Who will succeed key senior positions in the company and the board chairman? Is the next generation of leaders tied in any way to the directors, CEO, or chairman?*



Juan Carlos Fernandez, Manager of the IFC Vietnam Corporate Governance Project, presents "The Reality of Corporate Governance Practices" at the Forum's Media Workshop in March 2010. Twenty journalists participated in the workshop in Ho Chi Minh City and discussion topics included the perspective of foreign institutional investors regarding corporate governance, the views and relevant activities of the Ho Chi Minh City Stock Exchange, and investigative techniques for journalists.

Questions such as these can equip reporters to go after the facts and insights necessary for developing corporate governance stories. The challenge, however, will be in getting the answers. That's where reportorial skills come in.

"We find that the probability of restatement is lower in companies whose boards or audit committees have an independent director with financial expertise; it is higher in companies where the CEO belongs to the founding family."

Anup Agrawal and Sahiba Chadha
University of Alabama—Culverhouse College of
Commerce and Business Administration

Board Practices—Some Examples

The following findings are from the 2009 Spencer Stuart U.S. Board Index:

Independent leadership: Half of all boards have only one insider, the CEO, up from 44 percent last year. And 37 percent split the chairman and CEO roles, versus 20 percent a decade ago.

Majority voting: 65 percent of boards report that they require directors who fail to secure a majority vote from shareholders to offer their resignations. This is up from 56 percent last year.

Director term limits: One-year terms for directors are now the norm in 68 percent of S&P 500 boards, versus 38 percent 10 years ago.

In its survey of the top 100 U.S. companies in 2010, Shearman and Sterling, LLP, found the following:

Lead independent director responsibilities: 87 have specified responsibilities for their lead independent director (or independent chair) in addition to setting the agenda for, and presiding over, executive sessions.

Board size: The board's size ranged from 6 to 18 members, with an average of 12 members.

Strengthening Your Reportorial Techniques

Research. Research. Research. That's what leads to good reporting. Effective research involves being curious and asking the right questions, based on your knowledge of the topic. It requires that you, as a journalist, challenge business leaders, politicians, regulators, and anyone else involved in the story. If any of the answers are unclear, ask follow-up questions to get a better explanation—to get past the spin.

An example of good research is Bethany McLean's coverage of Enron for *Fortune* magazine.

Even though she didn't break the story about Enron, McLean's early investigations raised questions that ultimately led to the disclosure of financial manipulations, which in turn led to the company's downfall.

Be alert to inconsistencies, "record" performance, lack of responsiveness, and limited access to people and documents—all warning signs that problems may be lurking. Verify all comments and claims, perhaps by interviewing various stakeholders for evidence that supports or counters the official claims.

Whistleblowers can be valuable, but they come with certain dangers, including personal agendas that may taint the information they provide. Investors, analysts, and portfolio managers may also prove to be invaluable contributors. Blogs, "tweets," and social networks such as Facebook may be initial sources of information. Include them in your reporting, but make sure any information obtained from those sources is supported by independent information.

The more sources you can use to validate your points, the more credible the story is to readers, listeners, and others. Spend time cultivating your potential sources and establishing trust.

Company news is not just about numbers and past performance, but also how these results were achieved and what is expected to happen next. Read footnotes, small print, appendices, assumptions, accounting policies, and so on. See whether they have changed. Is there anything missing? What do firms fail to report?



Kazakhstan, October 2008: IFC Communications Officer Rasmina Gurbatova shares her experiences in reporting about corporate governance practices in Azerbaijan.

Write the story clearly and thoroughly.

In reporting the facts, help your audience understand the underlying issues. Take the time to explain complex topics simply. Find the most effective way to present the information. For instance, some points may have more impact if you use human interest stories to convey them.

Your news organization may want to use your story to launch a series of reports on personal finance to explain basic investment concepts and the impact of bad (or good) corporate governance actions on the value of an individual's investment portfolio.

Follow through.

After your stories appear, continue to monitor the company. Did the company's leadership promise reforms? Have they complied with their commitments? Is the company's performance demonstrating that the reforms are having intended impact?

Getting Your Corporate Governance Story On The Front Page

In the end, the story you pitch must be *news*. But, *what is news*? The term can be difficult to define, but most journalists agree that the following eight elements make up what is considered to be news:

Immediacy: Did board decision or company action occur today, or is it scheduled?

Proximity: How will the corporate governance matter affect the community, region, or country? If companies are poorly governed generally in a country, can the economy grow in a sustainable manner over the long term?

Prominence: Is the chairman, CEO, or board director well known?

Oddity: Did the board approve purchasing a beach resort when its business is computer manufacturing?

Conflict: Is there dissension among the board directors, investors, other stakeholders, the government, or senior management?

Suspense: Is there a deadline, for example, by which the company must prove that it is fiscally solvent to obtain new loans to stay in business?

Emotions: This news element—commonly called human interest—involves stories that stir our recognition of basic human needs, both psychological and physical.

Consequence: If conflicts of interest have led the board and senior management to make bad decisions, can the company stay in business? Are investors and markets adequately informed about those conflicts, and have they priced the consequences into the company's share value?

The Forum's Media Training and Toolkit

The goal of the Forum's Media Training Program is to build journalists' understanding about the range of issues in the realm of corporate governance, to demonstrate that these issues are of interest and importance to the wider reading public, and to link these issues to the overall strategic management of an enterprise. The Program has four components:

- **Approaching editors:** Journalists discuss how they pitch their editors to publish stories about corporate governance, and their strategies for building good relationships with editors.
- **Investigative skills:** Journalists share their experiences in investigating corporate governance issues, including their key information sources.
- **Reading annual reports:** Accounting experts teach participants how to interpret financial and nonfinancial information in a company's reports.
- **Corporate governance basics:** Speakers from national or international investment organizations share their perspectives and insights on the importance of corporate governance in investment decision-making.

The Forum is also finalizing a media toolkit. The objective is to create a tool that will be read and used by journalists who are

interested in business or economic reporting. The toolkit will provide information in three areas:

- What corporate governance is and its value to society;
- Why corporate governance must be covered; and
- How to find the story in corporate governance issues.

Chapters are dedicated to the role of boards, reporting and disclosure, regulatory issues, and the investor's perspective, plus a chapter on "special cases" focusing on governance of financial institutions, family-owned businesses, and state-owned enterprises. The Toolkit includes real-life examples and case studies from various markets and regions worldwide.

A second version of the Toolkit will be produced for trainers and organizations that are interested in running Corporate Governance workshops for journalists. This version will include a training manual to provide special adult-education tools to enhance the learning experience of the workshops.

To learn more, visit the Web site for Global Corporate Governance Forum's Media Training Program on Corporate Governance Reporting: www.gcgf.org



India: Tata's Search For An Heir

Financial Times reporter Joe Leahy looked at the challenges that the board of India's largest conglomerate, Tata Sons, faces in choosing a successor to its chairman. When Chairman Ratan Tata neared mandatory retirement age of 65 in 2002, the board concluded that he was "irreplaceable" and "opted to change his title to non-executive chairman, an act that allowed him to remain in charge for another five years." In 2005, the board again extended his term by raising the mandatory retirement for nonexecutive directors to 75. That left Tata to remain at the helm until 2012.

Leahy further reports:

Instead of simply opting for the most obvious successor—Noel Tata, the boss's half-brother—the group has said it will consider all candidates for India's biggest corporate job—including non-family members, Indians from outside the chairman's minority ethnic Parsi community, overseas Indians and even foreign nationals.

"The question of succession has become so pressing in Asian economies," says Jamie Allen of the Asian Corporate Governance Association in Hong Kong, that many families now talk about "family governance." Some Chinese families among the diaspora in Asia have set up councils to sort out personal problems, laying a stronger foundation for addressing formal business challenges. "The argument is: you can't get family business governance right if the family is squabbling so the first step is to get family governance sorted out," Allen says.

Source: Joe Leahy, "India: Tata's Search for an Heir," *Financial Times* (September 5, 2010).

NEXT ISSUE:

Lessons from deploying a targeted training program that addresses the unique needs of bank board directors, including risk governance and accounting/audit issues. The Forum has started its Financial Markets Recovery Project in Indonesia, in cooperation with the Indonesian Institute for Corporate Directorship. The project will, in due course, follow a trajectory across the East Asia Region through the Institute of Directors of East Asia (IDEA.net).