

Corporate Governance Scorecard — Versatile Tool for Companies, Investors, and Regulators

Experiences from Southeast Europe and East Asia



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Lessons Learned

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Companies with strong governance practices achieve higher market valuations. However, once good practices have been adopted, how can a board know whether its company remains on track? Where its strengths are? Its weaknesses? Are other companies doing better or worse? For many companies (as well as investors and regulators), scorecards are proving to be invaluable in providing a yardstick for measuring the level of fulfillment in implementing and monitoring corporate governance. This publication focuses on the lessons learned in developing and using scorecards effectively.

Corporate governance scorecards emerged in Germany in the late 1990s as government-owned companies were privatized, blue-chip companies experienced serious failures, and young companies needed equity capital. In 2000, the scorecard came out as one solution for investors and analysts who sought a tool to assess the quality of a company's governance, which would guide them in making investment decisions. Since then, the tool has been adopted in many emerging market and developing countries (including Bulgaria, Bosnia and Herzegovina, Croatia, Indonesia, Macedonia, Montenegro, the Philippines, Serbia and Vietnam), often with the support of IFC Corporate Governance Advisory Services and Global Corporate Governance Forum (the Forum).

"The corporate governance scorecards opened new opportunities for IFC Advisory Services in Southern Europe. Leveraging from the Forum's knowledge materials and network of experts, we undertook corporate governance reviews based on the scorecards in a number of companies. These in turn strengthened the interest for corporate governance and led to new requests for in-depth assessments of client firms."

Kiril Nejkov
IFC Corporate Governance Project Officer
Macedonia

Scorecards assist boards, investors, financial analysts, regulators, and other stakeholders to systematically assess the level of corporate governance that individual companies have achieved.

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).



“A corporate governance scorecard is an effective tool for all stakeholders to assess companies’ fulfilment of best practice. Its concise criteria provide relevant information that can be readily compared, a valuable asset for investors evaluating portfolio holdings and new investment opportunities.”

Christian Strenger

Member, German Corporate Governance Commission
 Vice-chairman, Forum’s Private Sector Advisory Group, who has been instrumental in developing corporate governance scorecards in Germany and many of the Forum’s client countries.

Benefits of Scorecards

The scorecard:

- Facilitates analysts’ and investors’ work through a systematic overview of relevant corporate governance issues
- Helps companies easily assess the “reach” and quality of their own governance, and points to opportunities for improvement
- Enables comparisons across companies, industries, and countries
- Can easily be made available to all interested parties (for example, online)
- Costs little to implement
- Raises awareness about good corporate governance practices
- Allows investors to set minimum scores for governance as part of general investment decision making

The scorecard is designed to address issues relevant to the particular environment in which the company operates, including a country’s corporate governance framework and priorities. There is no “one size fits all” for a **scorecard’s content and structure**, because local adaptation is key to the tool’s overall effectiveness.

Typically, the scorecard criteria are tied to a national corporate governance code (if the country has one) or internationally recognized corporate governance principles such as Organisation for Economic Co-operation and Development (OECD) *Principles of Corporate Governance*. These criteria may include shareholder’s rights, shareholders’ equitable treatment, disclosure and transparency, board responsibilities, and internal audit and control. In each of these areas, the scorecard poses questions to determine the level of fulfillment, which determines the performance score for a particular criterion. Space is provided for a numerical score and comments.

The criteria and answers are weighted to obtain the overall score for the company. This weighting allows the drafters to tailor the scorecard to local conditions and priorities.

The summary page gives an overview, showing the sum of the individual factors that contribute to the overall score.

German CG Scorecard: Criteria and Weighting

Supervisory Board	45%
Management Board	20%
Transparency	16%
Shareholders	12%
Internal Controls	7%
Total Score CG	100%

Companies that meet all the mandatory principles of corporate governance, as defined in the national corporate governance code and the legal framework, should achieve a score of approximately 75 percent. If a company fulfills the code’s additional recommendations and international best-practice standards, it can achieve the maximum score of 100 percent. This 25 percent “fulfillment gap” is designed to incentivize companies to pursue governance standards that are higher than just the mandatory recommendations.

The tool draws the attention of the board and senior management to the value of improving the company’s corporate governance practices. It is also useful in the company’s public-relations efforts to increase recognition. For investors, the scorecard aids in making well-informed decisions, because it helps with monitoring adherence to good practices and determining whether any improvements have been achieved.

Regulators can use the scorecard to diagnose weaknesses in their country’s overall corporate governance framework and its implementation. With this information, they can determine whether to provide additional guidance, promote training, or implement new regulations. Regulators can also target their enforcement efforts based on scorecard results.

How to Develop a Scorecard: Experiences from Southeast Europe and East Asia

Good corporate governance is more than minimum compliance with laws and regulations. So it is essential to develop practical ways of encouraging company executives do more than the minimum. One way to achieve this is the systematic analysis of the governance situation by the market participants via a scorecard.

Different benchmarks could be used as the basis of a scorecard. The following steps summarize one process for developing a scorecard.

Step 1: Identify a relevant corporate governance code or international best practices to define a scorecard's focus.

In most Southeast European countries where scorecards have been developed (Bulgaria, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia), national corporate governance codes already existed. In some countries, more than one code had been developed by different institutions.

In Serbia, where two codes exist, the Belgrade Stock Exchange's code was selected to be the basis for that country's scorecard, because it was streamlined in its approach, principles-based rather than rules-based, closely aligned to OECD Principles, related specifically to listed companies, and voluntary.

In Vietnam, the basis of the corporate governance scorecard was the OECD *Principles of Corporate Governance* and the national corporate governance framework. A scorecard tool, a questionnaire of 110 questions, was developed, focusing on the areas of good governance as represented in the OECD *Principles*.

Step 2: Involve regulators, stock exchanges, and other key institutions as local partners.

Key local stakeholders should be involved from the very beginning for successful development and implementation of the scorecard. Setting out and explaining the methodology and then gaining understanding and commitment are important steps in developing a scorecard.

What Is a Corporate Governance Code?

Corporate governance codes of best practice are sets of recommendations aimed at improving and guiding the governance practices of corporations within a country's specific legal environment and business context. The Forum has developed a Toolkit on how to develop, implement, and review a corporate governance code of best practice and has guided the work on more than 40 codes all over the world. The Toolkit is available on the Forum's website: www.gcgf.org

"Law sets minimum acceptable standards while the corporate governance code defines higher levels of ambition, something to strive for. The corporate governance code is a driving force to encourage the implementation of good corporate governance in the country." Per Lekvall, Swedish Corporate Governance Board

10 Steps in Developing a Scorecard

1. Identify relevant corporate governance code provisions or international best practices.
2. Involve regulators, stock exchanges, and other key institutions as local partners.
3. Select a local consultant to help develop the scorecard.
4. Create working groups with key stakeholders or the taskforces involved in code drafting.
5. Organize peer review of the final draft of the scorecard.
6. Train local partners to apply the scorecard.
7. Promote the scorecard.
8. Support companies in scorecard applications.
9. Encourage ongoing knowledge transfer to business community.
10. Support new uses of the scorecards.

In Serbia, where two codes exist, one code's owner is the Chamber of Commerce. The chamber has been actively involved in developing the scorecard to ensure its usefulness and maximum reach.

In Vietnam, the evaluation methodology was discussed extensively during a roundtable meeting with the State Supervisory Commission, the adviser, and rating-team members. Each question was reviewed for its validity and the appropriateness of the scoring parameters that would guide the raters' judgments. The rating team, comprising leading academics with business and corporate governance background knowledge, received training in corporate governance and in applying the questionnaire on a question-by-question basis prior to rating. A pilot involving 10 companies provided an opportunity to adjust the scorecard before applying it broadly.

Step 3: Select a local consultant to help develop the scorecard.

Both the preparation and the effectiveness of scorecards proved to be faster, smoother, and better managed when a local independent consultant was tasked—at the beginning of the scorecard's development—with writing and reviewing drafts. Sharing responsibility locally also helped ensure sustainability of this process.

The independent consultant should focus on adapting the scorecard to local conditions, while the institutional partners, as identified in Step 2, should customize the questions and weight their relative importance to reflect market realities.

In Bosnia and Herzegovina, Serbia, and Montenegro, one consultant was engaged—the LOK Institute for Economic Research and Organization. Since all the stakeholders were satisfied with the institute's work in Bosnia and Herzegovina, it was considered beneficial to apply its knowledge and experience to other countries, such as Montenegro and Serbia. Doing so proved to be effective, because the institute's experience helped compress the development time.

Macedonia's Institute of Directors (IoD) led the drafting of that country's scorecard, which was then shared with other stakeholders. This endeavor was one of the institute's first activities following its launch.

Step 4: Create working groups with key stakeholders or the taskforces involved in code drafting.

To provide additional legitimacy to a scorecard's development and ensure maximum buy-in, scorecard drafts should be discussed in larger forums or working groups composed of the relevant regulators and leaders in business and academia.

In Bulgaria, the scorecard concept was first introduced during the code's last stage. The Forum presented the approach and its advantages to the taskforce (which had been institutionalized as the Standing National Corporate Governance Commission) that had drafted the code. The Financial Supervision Commission, as a regulator, and the stock exchange, as a market institution, supported the initiative and participated in developing and promoting the scorecard.

Step 5: Organize peer review of the final draft of the scorecard.

During the final stage, drafters should return to the "source" and launch a review by international experts, incorporating their comments in the revision.

The final scorecard drafts in Southeast Europe, after passing local scrutiny, were distributed for review to see whether they would pass the "international test." Christian Strenger visited Bulgaria and Bosnia and Herzegovina to discuss the final version of the scorecard with local stakeholders, and the Forum's Private Sector Advisory Group members provided comments based on their experiences and expertise. After incorporating these points, the scorecards—the region's first-ever quantitative tools for measuring corporate governance—were ready for use.

Step 6: Train local partners to apply the scorecard.

As with any new tool, the scorecard's potential use provides opportunities and challenges that require careful management.

Developing a tool and providing it to end users without training will limit the potential for success. Therefore, training on the scorecard's application and its value should be provided to companies' boards and senior managers, the regulators, and other stakeholders.

Training workshops should support a scorecard's introduction. In addition to hands-on training on how to apply the scorecard, companies want to understand the scorecard's rationale and whether it contains additional "disguised" obligations. They may also be concerned that the stock exchanges and other relevant market gatekeepers would use the scorecard's final scores in ways that may adversely affect their business. These issues should be addressed during training sessions.

Step 7: Promote the scorecard.

Promotion of the scorecard must start immediately after its finalization. The objective of this effort is to widen and deepen the business community's understanding of the scorecard's benefits, reaching as many corporate decision makers as possible. These individuals may need to be persuaded that there is value—a business case, for example—in obtaining an objective picture of their company's corporate governance. Two effective measures are publishing articles in the national media and providing presentations during national conferences and other events.



Launch of the corporate governance scorecard in Hanoi, December 8, 2010.

Different Approaches to Rating

In most cases, the scorecard is a self-rating tool where companies rate themselves or with the help of external parties. In the Philippines, the Institute of Corporate Directors (ICD) took the lead of the scorecard initiative and used a slightly different approach: a company's score is determined partly by its level of public disclosures through regulatory and exchange filings as well as through its corporate website and investor communications programs. Companies first conduct a preliminary self-assessment; then, a team of specially trained students from the Ateneo Law School validates the self-assessments.

"With the self-rating approach, companies are more involved and stay current with emerging global governance issues and practices. In many companies, the scorecard evaluation undergoes board approval before being submitted to ICD through the regulator. Involving university students in the validation process will have a long-term effect in creating awareness and building a governance culture in the Philippines."

Jonathan Juan DC Moreno

Executive Director, Institute of Corporate Directors

The Obstacles

In Southeast European countries, initially, it was difficult to explain to different stakeholders why a scorecard was necessary and useful, since a code was already in place. But, once the practical benefits were clarified, most stakeholders fully embraced the idea.

Some companies expressed concerns that their "grade" would be publicized. They also questioned whether it was possible for corporate governance to be measured and given a "score." But, because the scorecard provides guidance for improving governance, these companies could see the value of this information—beyond the "grade"—in helping them focus on specific deficiencies. Indeed, some companies later appreciated having a numeric, or quantitative, result assigned to what they had perceived as not very tangible.

In Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia, the codes received public attention when they were first adopted, but it took aggressive marketing to move the scorecard back into the spotlight. This effort helped mainstream the discussion of corporate governance in those countries.

To broaden awareness and encourage more companies to participate and improve their scores, the Philippines Institute of Corporate Directors recognizes and awards the top-scoring companies during its annual dinner. ICD also holds an investors' forum for institutional investors to interact with the top-scoring companies.

Steps 8 and 9: Support companies in scorecard applications and encourage ongoing knowledge transfer to business community.

To achieve corporate governance reviews in individual companies in Southeast Europe, IFC Corporate Governance Advisory Services arranged visits throughout the region to meet local institutions (stock exchanges, consultants, partners) and selected listed companies. Through this outreach, IFC sought to achieve two goals: to provide tailored advice to selected companies on how they can use the scorecard, and to improve their corporate governance practices (especially in those areas least aligned with national practices). IFC also transferred knowledge and skills to local institutions and stakeholders to build a foundation for advice it could provide in the future.

In Bosnia and Herzegovina, the stock exchange representatives especially appreciated the opportunity to conduct onsite visits at the companies. In some cases, it was the stock exchange's first visit to these companies.

In Macedonia, the IoD gained the business community's trust as an institution that is willing and able to produce different tools to improve corporate governance and provide concrete, practical advice.

In Serbia, inclusion of the stock exchange and the Serbian Chamber of Commerce in company visits helped reduce the institutional conflict resulting from the existence of two codes. It also fostered greater cooperation between the two institutions.

Step 10: Support new uses of the scorecards.

The scorecard is not the final destination. It can be used to drive innovation in two areas: creating customized scorecards for different sectors and types of companies (for example, state-owned enterprises, family-owned businesses); and, launching stock exchange indexes composed of companies participating, for example, in a scorecard program.

In the Philippines, scorecards have been developed for banks, insurance companies, and government-owned and government-controlled corporations. The Macedonian Stock Exchange and the Serbian Chamber of Commerce developed scorecards specifically for limited liability companies.

The Bulgarian Stock Exchange's Corporate Governance Index includes the 10 listed companies with the best corporate governance standings. The rules for evaluating the companies are prepared jointly by the exchange and the National Corporate Governance Commission, using a scorecard.



In Macedonia, the IoD developed two separate programs—one for the stock exchange and another for the Macedonian Securities and Exchange Commission—to tailor training to these institutions' specific needs. Any listed company can download the corporate governance scorecard from the Macedonian Stock Exchange website.

Forging Public-Private Sector Cooperation

During 2006–2007, the Philippines ICD encountered challenges in encouraging companies to complete the scorecard. Out of more than 200 companies, only 49 companies participated in the first year and 64 companies in the second year, with very low average scores of 53 percent and 54 percent, respectively. Through a partnership forged between the institute and the regulators, the stock exchange and Financial Supervision Commission required companies to participate in the scorecard project and imposed monetary fines on those that would not. During the third year, 138 companies participated, with an average score of 65 percent; in the fourth, 169 companies, with 72 percent; and in the fifth, 214 companies, with 73 percent. Every year, companies that regularly participate in the scorecard gradually increased their scores. However, the higher scores were offset by the low marks of newly participating companies, pulling down the average score.

Voluntary or Mandatory?

In most countries, scorecards are voluntary, but in some cases the regulators opt to make them mandatory for listed companies to further improve disclosure on corporate governance practices. In Montenegro, the Securities and Exchange Commission believes that completing the scorecard should be mandatory for all companies under its jurisdiction. A similar approach was adopted in Bulgaria, and the Macedonian Securities and Exchange Commission is also considering this option.



Representatives from regulators, national banks, government and business institutions, and IFC Advisory Services—from Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, and Tajikistan—discuss how to monitor and implement corporate governance codes in their countries, at a regional workshop in Baku, February 8–9, 2011.

Forum Resources

Toolkit 2: Developing Corporate Governance Codes of Best Practice

Although globalization has increased and international corporate guidelines have been adopted, each country has its own values, social norms, ways of doing business, and special circumstances. This Toolkit guides policymakers, market participants, and corporations in adopting sound corporate governance codes.

Visit www.gcgf.org/codes

Visit www.gcgf.org/publications



Private Sector Opinion:

Governance Scorecards as Tools for Breakthrough Results.

Issue 8. Jesus P. Estanislao, chairman of the Institute of Corporate Directors and president of the Institute for Solidarity in Asia, introduces scorecards and shows how they can help companies improve their governance.

Developing and Implementing Corporate Governance Codes.

Issue 10. Simon C. Y. Wong, adjunct professor of law at Northwestern University School of Law and former head of corporate governance at Barclays Global Investors Limited, addresses the code's key advantage versus that of a mandatory approach in regulating three aspects of corporate governance: dissemination, flexibility of corporate practice, and transparency.

Macedonian Komercijalna Banka Implements Recommendations Based on the Scorecard

In January 2010, the IFC Corporate Governance Project and Institute of Directors of Macedonia undertook a corporate governance review in Komercijalna Banka, the largest domestically owned bank in the country, through the corporate governance scorecard.

Based on the scorecard results, Komercijalna Banka received ten concrete recommendations to further improve its corporate governance practices. Komercijalna Banka requested that IFC and the Institute of Directors deliver training to its management to explain the recommendations.

In October 2010, Komercijalna Banka provided a letter to IFC, stating that it had implemented eight out of the ten recommendations, including improvement of its transparency in relation to the quantity and quality of information disclosed on its website, as well as establishment of a nomination committee. Komercijalna Banka received the Crystal Bell Award for the most transparent company listed on the Macedonian Stock Exchange for 2010. Even though the bank already had higher standards of corporate governance than its peers, use of the scorecard inspired it to improve its practices even further.

NEXT ISSUE:

The global financial crisis exposed weaknesses in banks' corporate governance systems, particularly in their risk management policies and procedures. To help banks address these problems and thereby prevent, or at least mitigate, future systemic banking crises, the Forum launched the Financial Markets Recovery Program. The lessons from program design and rollout can inform work of bank board directors and training professionals working with financial institutions.

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