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Focus

Corporate Governance

Scorekeepers, Rankers, Raters Will Shape Company Reputations

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Hank Boerner is Managing Director-New York of Rowan & Blewitt, an issues and crisis management consulting firm serving the Fortune 500 and multinationals. He specializes in helping companies deal with corporate governance, accountability, and social responsibility issues and challenges.

A cottage industry of "scorekeepers" now analyze, judge, rate, and otherwise qualify public companies' corporate governance and accountability practices.

Among the most important of these scorekeepers are the credit rating agencies. In 2002, troubled by the accounting shenanigans of some large companies, Standard & Poor's established its own measurement of corporate earnings--only "core earnings" derived from a company's core operations are now counted. That means companies in an S&P index--such as the S&P 500--will see earnings from one-time sales or extraordinary events discounted or eliminated in important S&P calculations. S&P has also embarked on a program to develop corporate governance scores that will become an important offering for the McGraw-Hill-owned company.

Institutional Shareholder Services, which advises many institutional investors during proxy season, created the "Corporate Governance Quotient," which scores companies (1-to-100, 100 being ideal) on seven major topics and 51 subsets of governance issues. These CGQ scores (initially covering the Russell 3000 companies) are available to subscribers, including many mutual funds and pension plans, and eventually will include all publicly traded companies.

The ISS topics are board structure and composition; charter and bylaw provisions; laws of the state of incorporation; executive and director compensation; qualitative factors, including financial performance; directors and officers' stock ownership; and director education.

Commenting on recent governance trends, ISS Vice President and Director of Corporate Programs Patrick McGurn noted, "We are seeing both revolutionary and slower-paced evolutionary moves to improve corporate governance standards and practices. Both public sector initiatives and private sector voluntary steps are intended to rebuild investor confidence. The chief executive officer's independence is being directly challenged in all this; he or she may be operating more under board control in the days ahead."

McGurn believes the changes underway will result in boards having a "lead director," who would manage board operations, and the separation of chair and CEO positions, with a full-time chair providing clear counterweight to the CEO who would separate from board duties to manage the affairs of the company.

Watchdogs to Watch

Other organizations that will help shape the reputations of public companies (and factor in targeting companies for proxy battles and other actions) include:

- *Domini 400 Social Index*, which uses publicly available information and proprietary screens to determine the 400 socially conscious companies to be included in the index. A number of socially responsible investors (SRIs) use the index for investment decisions, including Domini Social Investments ($2 billion capitalization). (Note that an estimated $1 of every $8 invested in equity funds is in one of 200 SRI funds.)

- *FTSE4Good*, an index series for socially responsible investment that includes companies selected from The Financial Times (FT) global indexes based on environmental performance, support for universal human rights, and positive relations with stakeholders.

- *Interfaith Center on Corporate Responsibility (ICCR)*, a coalition of 275 faith-based investors, representing institutional holdings of $100 billion. Its members' concerns include energy and the environment, global corporate accountability, global finance and community economic development, international health, militarism and violence, and improvement in corporate governance. Virtually all major denominations are members, and for 25 years it has waged broad-based, aggressive proxy campaigns, targeting most major corporations.

- *The Center for Financial Research and Analysis (CFRA)*, headed by former accounting professor Howard Schilit. CFRA provides confidential analysis of "financial shenanigans" to a client base of 3,000 investment professionals and 800 institutional investment organizations. In 2003, CFRA will launch its "Diagnostic Reports," focusing on the quality of earnings for every S&P 500 company (including analysis of financial reporting).

- *AFL-CIO Office of Investment*, which provides voting guidelines to member unions and other shareholder activists. Union funds invest about $450 billion.

- *TIAA-CREF*, Teachers Insurance and Annuity Association-College Retirement Equities Fund--the nation's largest pension fund--adopted corporate governance guidelines several years ago, and regularly meets with management (and board members) to discuss corporate governance improvements in companies in which the fund invests.

- *CalPERS*, the California Public Employees' Retirement System, also has published corporate governance guidelines, and asks companies in which it invests to adopt them (or at least parts thereof).

- *Council on Institutional Investors (CII)*, the trade group for many institutional investors, publishes guidelines for its member groups.