

# IRQ

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## Through the IR Looking Glass

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53 PERSPECTIVES ON IR  
In the Know

**PERSPECTIVE ON RATINGS:  
SCORING CORPORATE GOVERNANCE**

BY HANK BOERNER



*Investor Relations Quarterly*

**NATIONAL INVESTOR RELATIONS INSTITUTE**

**PERSPECTIVES ON IR****In the Know****How Audiences Relate to  
IR Practices**

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*Ask investor relations practitioners why their role has expanded and the list of reasons is likely to start with legal and regulatory initiatives, splash-over from corporate scandals and Wall Street upheaval, or the effects of the bull market. Good reasons, all. Yet another development that deserves to be listed but seldom is articulated is that IROs increasingly touch more audiences with broader expectations for the IR function. IRQ asked representatives of several key audiences what they expect of IROs.*

**PERSPECTIVE ON RATINGS:  
SCORING CORPORATE GOVERNANCE****BY HANK BOERNER***Managing Director*

ROWAN &amp; BLEWITT

Investor relations officers usually focus on their companies' equities and are not often involved in the credit rating process. They view the debt markets as the province of the corporate treasurer and others, because credit ratings are intended for use in debt or fixed-income markets.

Traditional credit ratings—more accurately, credit risk profiles—are important tools for both private and publicly owned corporations. The rating assigned by an independent, objective agency is required for access to the debt markets and determines cost of funds. A Standard & Poor's, Moody's or Fitch rating will be necessary at some point in the growth cycle of every business.

Forward-looking IROs are beginning to pay more attention to the credit agencies, following the lead of equity analysts who are now focusing on published credit and risk ratings as they perform their evaluations. Investors have learned that events in the credit market, such as a credit downgrade, can immediately affect the share price of the company involved.

That bridge between ratings and investing decisions is catching the attention of a number of agencies and investment community advisers. In various forms, they are developing scores that apply the concept of attribute measurement to equity-related topics. One of the more promising is the corporate governance score developed by Standard & Poor's, which is relying on its reputation for objectivity and reliability as well as its assessment skills to develop a comprehensive process for evaluating and scoring corporate governance, which may well become the primary crossover product of importance to both credit and equity institutional investors.

S&P develops the in-depth corporate governance scores that it publishes for public companies independently from its credit-rating operations. The McGraw-Hill Company subsidiary points out that it has built fire walls between its rating groups to make sure that no confidential information gathered by its credit-rating operations is shared with those who calculate corporate governance scores.

## **CORPORATE GOVERNANCE SCORES**

The corporate governance scoring process is based on two important principles:

1. Corporate governance as the interaction of a company's management, board and shareholders to ensure that all financial stakeholders—shareholders and creditors—receive their fair share of the company's earnings and assets.
2. The corporate governance score is an opinion. In the case of the corporate governance score from S&P, it is the view of that agency's experts on the extent to which, after careful evaluation, they perceive that the client company has adopted codes and guidelines of generally accepted corporate governance practices that clearly serve the interests of its financial stakeholders.

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S&P began developing its corporate governance score in 1998 in response to customer requests for information on emerging markets such as Russia and Asia-Pacific. The initial scoring of corporations outside the United States began in 2000, and the scoring of U.S. companies began in October 2002.

### **TAKING PART IN THE SCORING PROCESS**

Investor relations officers and others who are drawn into the corporate governance scoring process should evaluate its impact from several angles:

- Whether the board or executives believe that the company would benefit from a thorough corporate governance review that leads to compiling an evaluation and possibly publishing the score
- Whether the company can interact with the reviewing body during the evaluation and analysis process
- Whether the reviewing body looks at both public and nonpublic information

The S&P corporate governance scoring process is voluntary, interactive and focused on both public and nonpublic information, excluding confidential material provided to its credit rating arm. As with S&P credit ratings, it is solely up to the client company's discretion whether to make the corporate governance score public; the company can request a confidential governance evaluation and keep the results confidential. The company can also use the evaluation to improve its governance and then have a score developed and published, by S&P and through its own communication avenues.

### **WHAT IS EVALUATED?**

The agencies and services that have begun developing scoring systems typically review key elements and related components like the following:

- **Ownership.** The structure and influence of external shareholders and transparency of ownership
- **Investor Participation.** Investor rights, stakeholder relations, shareholder voting and meeting procedures, ease of access to meeting information
- **Financial Matters.** Communication transparency, information disclosure, quality and content of public disclosure, auditor independence, audit process
- **Governance.** Board structure and process, board composition, the board's role and effectiveness, outside directors' role and independence, compensation

The scoring documents provide detail on each component that the provider identifies as critical. S&P's corporate governance score uses a range of 1 to 10, with 9 to 10 considered very strong and the middle of the range a good outcome for an initial evaluation.

## RELEVANCE TO INVESTOR RELATIONS

At present there is still considerable discussion about the value and effectiveness of various corporate governance scores and ratings being offered by pioneering providers in the wake of Sarbanes-Oxley legislation. To the extent that corporate governance becomes a critical factor in financial analysis and investors pay more attention to companies' scores, the independent scores and ratings could become important tools for investor relations officers. A McKinsey survey in 2000 found that investors were ready to pay a premium for companies that practice good governance. A follow-up in 2001 revealed that board practices were as important as financial performance in evaluating investment opportunities. A separate survey by Harvard's Paul Gompers demonstrated an 8.5 percent excess annual return for well-governed companies.

There could be another value for the client company that commissions such an evaluation: It will give management a framework for benchmarking the organization's corporate governance best practices and identifying areas needing attention and improvement. This resource could be helpful as new corporate governance rules for NYSE- and Nasdaq-listed companies take effect and compliance with those new rules requires objective guidance.