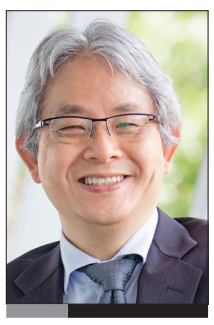
Governance of governance awards and ratings

ENRON (United States), China Aviation Oil (Singapore), Satyam (India) and Sun Hung Kai (Hong Kong). Many would recognise them as companies that have been caught in major scandals. However, they were also companies that won best governance or transparency awards and accolades just before they imploded.



Guest writer

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Why do companies sometimes receive governance awards or receive high governance ratings, shortly before they get into governance scandals? There are several reasons. One is of course the lack of adequate information on the part of those involved in selecting or rating companies.

Some organisations focus on winning awards for "marketing" purposes – a bit like the way they focused on getting ISO and other certifications. Some set up teams to handle the application for the award and are less focused on delivering "good governance" than on presenting their governance practices and procedures in a way that will win the award. If the award organisers do not do a thorough job of reviewing the organisation's practices, what happens is that they are really reviewing the quality of the submitted information, rather than the quality of the practices of the organisation. The "Oscars" may be an appropriate analogy. It's often not the best film or actor that gets the award, but those whose studio spends the most money in promoting the film or actor.

Another related reason is that award panels sometimes mistake charisma for competence, profile and publicity for achievements and business performance for good governance, when recognising individuals and companies in governance awards. A third reason is the questionable background or motivation of the organisation responsible for organising the awards.

When the Satyam scandal broke, I wrote about the corporate governance lessons (*Looking good versus doing well*, *Business Times*, Jan 12, 2009). I had expressed surprise that an organisation which was reportedly based in the United Kingdom with the rather grandiose-sounding name of World Council for Corporate Governance (WCFCG) would have the necessary information to be able to pick an Indian-based company for its best corporate governance award in September 2008 – especially as it appeared to be quite an exclusive award.

About three months after receiving the award, Satyam was blacklisted by the World Bank for providing "improper benefits" to its staff, which was then followed in January 2009 by the confession by its founder-chairman about the fraud. The founder-chairman had also in 2007 won a prestigious Entrepreneur of the Year award given by one of the major accounting firms, even though he had faced allegations of fraud, tax evasion and rigging of land prices.

After my commentary was published, I decided to check out the WCFCG further. I had expected the body to be highly international in nature, given its name. In fact, while it was indeed registered in the UK, the council members were almost exclusively Indian nationals, although it was able to put together a relatively prestigious UK judging panel for its awards. Given the background of the WCFCG members, picking India-based Satyam as the winner in what was promoted as a global award was perhaps not a surprise after all.

A few years ago, I received an email from an organisation inviting me to join its "global judging panel" for a new "prestigious" corporate social responsibility (CSR) award. I was curious so I checked it out, and discovered that the awards were organised by a commercial firm based right in Singapore specialising in training and organising conferences, particularly CSR-related conferences. I wonder how many of their conference and training participants are award winners.

Some organisations don't even bother to hide the fact that they are using awards to sell services. Last year, I received an email from someone who wanted to know if I was interested in collaborating in producing a CEO League Table in Singapore. The person claimed that they have done this successfully in a European country, and that they have developed a ranking algorithm that identifies outperforming CEOs "based purely on financial data with no subjective biases". A bold claim, although I could not imagine that you could rate CEOs purely on financial data unless you assume that the CEO alone is responsible for all the financial achievements (and missteps) of a company. But what really troubled me was his statement that their experience in the European country shows that celebrating high performing CEOs helps them sell services to CEOs.

For corporate governance-related awards, an investor body, media organisation or independent organisation such as a university seems most well suited to be the organiser. Governance awards and ratings are generally intended to raise corporate governance standards and increase investor interest in the better companies, and an investor body or the business media that are constantly scrutinising companies would align well with the objectives of awards and ratings. Universities can bring the quality of independence and objectivity. This is not to say that these organisations do not face conflicts, and here is where the governance around the selection and judging process becomes critical, a point I will come to shortly.

In some countries, directors' institutes are heavily involved in awards and ratings. A perception problem here is the close relationship between companies and boards with the directors' institute affecting the objectivity of the awards and ratings process, and that joining as members or attending its training will give a company an edge. The perceived conflict would be worse if the directors' institute also offers other services, such as board advisory services. It is perhaps interesting that in the developed markets like Australia and UK, the directors' institutes play no part in any awards or rankings – focusing instead on their core objectives of professional development of directors,, advocacy and perhaps helping companies identify potential directors.

However, perhaps the most important reason why governance awards and ratings may not be totally independent and objective is the lack of proper governance in the selection and judging process. Award organisers often rely extensively on other organisations and individuals to help them in shortlisting companies and selecting winners. The selection process, and perceived independence, knowledge and credibility of the judging panel and those involved in assessing companies and individuals for consideration, are extremely important.

This is where other conflicts may surface. For example, where commercial firms are intimately involved, it raises the question of whether their involvement is a means of selling services and whether their clients have advantages over non-clients. Imagine a firm that sells board-related services and the winners of the best board awards are always someone else's clients. It would not look good for the firm, and over time, the firm may question the commercial justification for its continuing involvement. It would be worse if the winners are mostly the firm's clients. Would the evaluation criteria be biased because they are based on advice provided in their services to clients? A diverse panel should be involved in developing the shortlisting criteria. Perhaps if commercial firms are involved in helping screen companies for awards, this role should be rotated among different firms every two to three years, rather than one firm having exclusivity. Ideally, it is best not to have commercial firms involved in the shortlisting of candidates for consideration.

Many award organisers have rules about individual judges declaring their interest if a client is being considered. Where a commercial firm is closely involved in the assessment of firms for awards, declaring interest would have limited usefulness in addressing the conflict of interest.

As there are so many awards and ratings in the marketplace now, and more commercial organisations using awards and ratings to sell services or as a direct money-generating exercise, it would seem that some guidelines around the governance of awards and ratings would be helpful to help stakeholders judge the credibility of these awards and ratings.

Here are my proposals for a set of guidelines to improve governance of awards and ratings and for stakeholders to assess the credibility of these awards and ratings. We can call it a Code of Governance for Awards and Ratings.

- Disclosure of the identities and resumes of all members of the judging panel and the panel secretariat, including their major affiliations (in particular, commercial firms they are affiliated with);
- Avoidance of use of commercial firms as secretariat if possible, and if not, have rotation policies in place so that other firms have an opportunity to be involved;
- Adoption of rules for declaring interest and abstaining/recusing from discussion where there is a conflict of interest;
- Disclosure of all sources of funding for the awards/ratings;
- Disclosure of any commercial interest or other relationships between members of the judging panel and panel secretariat, and the award winners; and
- Disclosure of the methodology used in scoring and the selection/ranking process.

Any organisation that is involved in governance-related awards or ratings needs to ensure that it has proper governance in place in administering these awards or ratings. How ironic it would be to have bad governance for good governance awards and ratings. FocusM

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