Economist Intelligence Unit

The Economist

Corporate governance
The new strategic imperative

A white paper from the Economist Intelligence Unit

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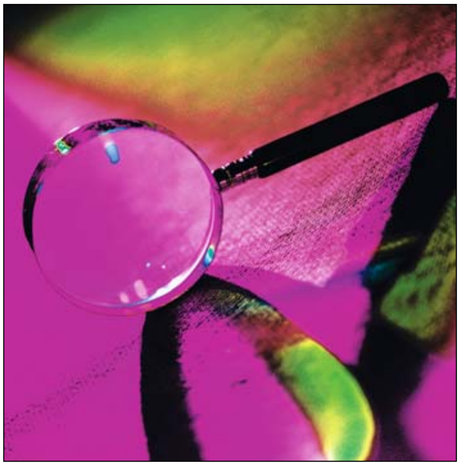
Corporate governance: The new strategic imperative was written by the Economist Intelligence Unit and sponsored by KPMG International.

The Economist Intelligence Unit bears sole responsibility for the content of the report. The Economist Intelligence Unit's editorial team conducted the interviews and online survey and wrote the report. Victor Smart was the main author. The findings and views expressed in this report do not necessarily reflect the views of KPMG International, which has sponsored this publication in the interests of promoting informed debate.

The research effort for this report comprised a number of key initiatives:

- The Economist Intelligence Unit conducted a special online survey to test the attitudes of senior executives worldwide to corporate governance. One hundred and fifteen international executives participated in the survey, which was conducted in June-July 2002; full survey results are available in an appendix to this report.
- A series of in-depth interviews were held with leading corporate and regulatory figures in July and August 2002. Executives at over 30 different institutions worldwide were interviewed from a diverse range of countries and industries.
- The Economist Intelligence Unit also undertook substantial desk research into corporate governance and transparency practices worldwide. The research effort was co-ordinated by Anthony Ray.

Our deepest thanks go to all the interviewees and survey respondents for sharing their insights on the topic.



Corporate governance

The new strategic imperative

Executive summary

Nearly a year after the Enron revelations first surfaced, corporate governance dominates the political and business agenda. After a slew of scandals, most of them centred in the US, politicians and regulators, executives and shareholders are all preaching the governance gospel.

But has the pendulum swung too far? This white paper from the Economist Intelligence Unit reveals concern among executives that hasty regulation and overly strict internal procedures may impair their ability to run their business effectively. CEOs have to bear in mind the potential trade-off between polishing the corporate reputation and delivering growth—for all the headlines on corporate responsibility, are investors prepared consistently to sacrifice earnings for the sake of ethics?

Four main conclusions emerge from this white paper:

- Regulations are only one part of the answer to improved governance. Corporate governance is about how companies are directed and controlled. The balance sheet is an output of manifold structural and strategic decisions across the entire company, from stock options to risk management structures, from the composition of the board of directors to the decentralisation of decision-making powers. As a result, the prime responsibility for good governance must lie within the company rather than outside it.
- Designing and implementing corporate governance structures are important, but instilling the right culture is essential. Senior managers need to set the agenda in this area, not least in ensuring that board members feel free to engage in open and meaningful debate. Not all board members need to be finance or risk experts, however. The primary task for the board is to understand and approve

Ten ways for a CEO to improve corporate governance

1. **Schedule regular meetings of the non-executive board members from which you and the other executives are excluded.** Non-executives are there to exercise "constructive dissatisfaction" with the management team. They need to discuss collectively and frankly their views about the performance of the executives, the strategic direction of the company and worries about areas where they feel inadequately briefed.

2. **Explain fully how discretion has been exercised in compiling the earnings and profit figures.** These are not as cut and dried as many would imagine. Assets such as brands are intangible and with financial practices such as leasing common, a lot of subtle judgments must be made about what goes on or off the balance sheet. Don't hide these, but use disclosure to win trust.

3. **Initiate a risk-appetite review among non-executives.** At the root of most company failures are ill-judged management decisions on risk. Non-executives need not be risk experts. But it is paramount that they understand what the company's appetite for risk is—and accept, or reject, any radical shifts.

4. **Check that non-executive directors are independent.** Weed out members of the controlling family or former employees who still have links to people in the company. Also raise awareness of "soft" conflicts. Are there payments or privileges such as consultancy contracts, payments to favourite charities or sponsorship of arts events that impair non-executives' ability to rock the boat?

5. **Audit non-executives' performance and that of the board.** The attendance record of non-executives needs to be discussed and an appraisal made of the range of specialist skills. The board should discuss annually how well it has performed.

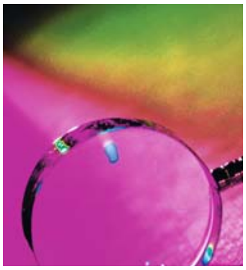
6. **Broaden and deepen disclosure on corporate websites and in annual reports.** Websites should have a corporate governance section containing information such as procedures for getting a motion into a proxy ballot. The level of detail should ideally include the attendance record of non-executives at board meetings. If you have global aspirations, an English-language version must be available.

7. **Lead by example, reining in a company culture that excuses cheating.** Don't indulge in sharp practice yourself—others will take this as a green light for them to follow suit. If the company culture has been compromised, or if you are in an industry where loose practices on booking revenues and expenditure are sometimes tolerated, take a few high-profile decisions that signal change.

8. **Find a place for the grey and cautious employee alongside the youthful and visionary one.** Hiring thrusting MBAs will skew the culture towards an aggressive, individualist outlook. Balance this with some wiser, if duller heads—people who have seen booms and busts before, value probity and are not in so much of a hurry.

9. **Make compensation committees independent.** Corporate bosses should be prevented from selling shares in their firms while they head them. Share options should be expensed in established companies—cash-starved start-ups may need to be more flexible.

10. **Don't avoid risk.** No doubt corporate governance would be a lot simpler if companies were totally risk averse. But in the words of Helmut Maucher, honorary chairman of Nestlé, "You have to accept risks. Those who avoid them are taking the biggest risk of all."



both the risk appetite of a particular company at any particular stage in its evolution and the processes that are in place to monitor risk.

- There is an inherent tension between innovation and conservatism, governance and growth. Asked to evaluate the impact of strict corporate governance policies on their business, 45% of the executives surveyed by the Economist Intelligence Unit for this report thought that M&A deals would be negatively affected because of the lengthening of due-diligence procedures, and 36% thought the ability to take swift and effective decisions would be compromised. State-of-the-art corporate governance can bring benefits to companies, to be sure, but also introduces impediments to growth.
- Transparency about a company's governance policies is critical. As long as investors and shareholders are given clear and accessible information about these policies, the market can be allowed to do the rest, assigning an appropriate risk premium to companies that have too few independent directors or an overly aggressive compensation policy, or cutting the costs of capital for companies that adhere to conservative accounting policies. Too few companies are genuinely transparent, however, and this is an area where most organisations can and should do much more.

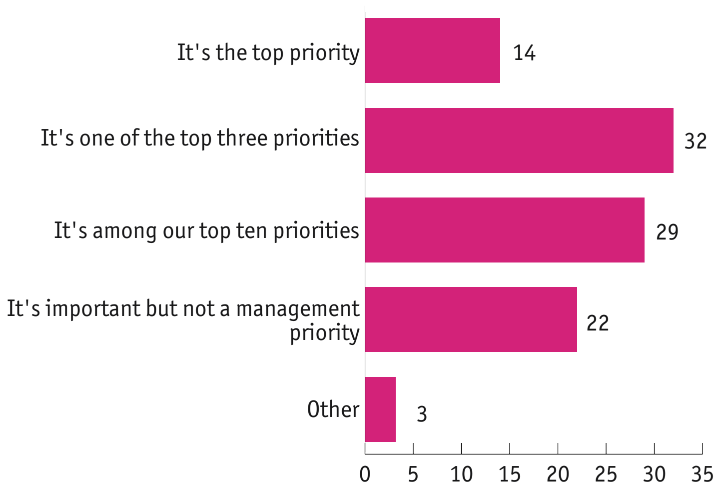
Introduction

Nearly a year after the Enron revelations first surfaced, corporate governance dominates the political and business agenda. After a slew of scandals, most of them centred in the US, politicians and regulators, executives and shareholders are all preaching the governance gospel.

US lawmakers have reacted most vigorously, passing a tough new corporate reform bill that establishes an oversight board for auditors of public companies and criminalises securities fraud. Many non-US firms find themselves bound by the new law, and jitters about corporate fraud have affected financial markets worldwide—government reviews into governance are under way in the UK, Germany, the European Commission and elsewhere.

Within companies, a bout of intense self-scrutiny is in train. Robert Miller, chairman and CEO of Bethlehem Steel and a director of four other public companies, remarks, "Ever since Enron imploded, every board I'm on has asked, 'What lessons can we learn and what should we do differently?'" In a new Economist Intelligence Unit survey of senior executives worldwide, 46% of respondents say that corporate governance is one of their organisation's top three current priorities—and for 14%, it is the top priority.

Agenda topper
Where does corporate governance rate in your list of current priorities?
% of respondents



Source: Economist Intelligence Unit online survey, July 2002.

No one disputes the need for transparency, honesty and accuracy on the part of corporations. But has the pendulum swung too far? This white paper from the Economist Intelligence Unit reveals concern among executives that hasty regulation and overly strict internal procedures may impair their ability to run their business effectively. One investment analyst comments that "working on the something-must-be-done principle, the temptation for regulators is to come up with a new, stricter set of rules that won't be understood and indeed may even obfuscate things and fail to win respect."

Meanwhile, CEOs have to bear in mind the potential trade-off between polishing the corporate reputation and delivering growth—after all, despite the headlines on corporate responsibility, are investors really prepared consistently to sacrifice earnings for the sake of ethics? Respondents to the EIU survey were asked which factors posed the greatest threat to their share price. The greatest dangers were market risk (39%), a shortage of top-quality management (37%), reputational risk (32%) and a failure to innovate (29%)—poor financial results and disclosure did not figure in the top four threats.

Defining terms

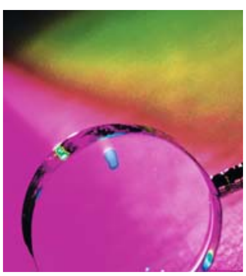
Corporate governance is about promoting corporate fairness, transparency and accountability. Yet a precise definition of what is a relatively new-ish concept remains blurred. Some take a narrow view, seeing "governance" as a fancy term for the way in which directors and auditors handle their responsibilities towards shareholders. Others expand the concept to explain a firm's relationship to society, often blurring the distinction between corporate governance and corporate social responsibility.

Few, however, will cavil at the following 1999 definition from the OECD:

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

The blunt instrument of regulation

Today's corporate turbulence may seem unprecedented, but we've been here before. In his book "The Great Crash 1929", J K Galbraith chronicled how an asset bubble breeds lax accountability. The bubble's collapse exposes malfeasance as money gets tight. This creates loss of investor confidence and public outrage, which in turn prompts a hasty reaction by lawmakers and regulators. The worry for today's executives is that the 2002 version of this cycle will result in inappropriately far-reaching rules.



After all, despite the welter of American scandals, it's worth restating that corporate governance works satisfactorily in thousands of firms. Or, as veteran investment banker Derek Higgs, the non-executive director of Allied Irish Banks, who is leading an official review into the role of Britain's non-executive directors, remarks, "I don't think that in the UK or even, perverse as it may sound, in the US, things are actually so badly wrong."

More to the point, regulation remains a very blunt instrument to tackle a hugely complex area. According to Mr Higgs, "The first thing in this game is that there are no absolutes. There are no blacks and whites. There is no such thing as getting it right—there are only behaviours that tend to improve the outcomes."

Indeed, some argue that it is no coincidence that today's corporate scandals have been centred in a country with a very legalistic culture. Peter Forstmoser, chairman of Swiss Re, one of the world's largest reinsurers, and a veteran of the corporate governance scene, comments, "In America in particular there is too much emphasis on form. You hear stories about board members attending meetings flanked by their attorney and everyone having a very tick-box mentality. If you have that approach, you can't have an open discussion to find a solution to problems."

Alistair Johnston, who is managing partner of global markets at KPMG International, one of the Big Four accountancy firms, remarks, "The critical and over-riding question is 'do the financial statements fairly present the company position in a way that is clear and transparent to all stakeholders?' "

Mr Johnston and others favour the approach based on the guiding principle of "truth-and-fairness" which is used by the International Accounting Standards Board. Says Mr Johnston: "We need to empower boards, the audit committee and the accounting profession so that whatever the detailed rules may say, they can assert that substance matters more than form."

Just mandating greater disclosure doesn't necessarily help. Ted Awty, UK head of assurance at KPMG, comments, "One of the problems of transparency is that disclosure soon becomes so voluminous that it ceases to be transparent. In the case of Enron, if you read the accounts in sufficient detail it is pretty much all there. But what does it mean? Clarity and openness are often in the minds of regulators but they can be translated by companies as sheer volume of disclosure, which isn't effective."

Similarly, an understandable desire on the part of regulators and politicians to believe that accountancy boasts a quasi-mathematical precision, thereby justifying sending errant chief executives to prison, risks seeming like wishful thinking. An accurate appraisal of corporate performance is a surprisingly elusive goal. The reason for this is not pilfering by executives, but because there are genuinely different views on assessing the value of assets such as brands, goodwill, intellectual capital, and the appropriate ways to expense items such as bid costs (see box, page 7).

Whereas in the past it was possible for a CEO to say, "these are our assets and these are our earnings", nowadays there is far more room for quite legitimate discretion. It takes a non-accountant, Paul Coombes, director of McKinsey's corporate governance practice, to state baldly, "The notion

Capita expenditure

In July, when the frenzy about misstatements of earnings was at its height, Capita, a fast-growing FTSE-100 outsourcing firm in the UK, saw its share price hit badly by rumours about accounting for bid costs in the sector. Analysts were alarmed that hefty expenses were being capitalised by the industry rather than deducted in a routine way.

Since Rod Aldridge, executive chairman, maintains that Capita is the FTSE's most transparent company, the response was to further "double disclosure". At the time of the half-year results, 100 analysts and fund managers were invited to a numbers-heavy session in which executives laid bare how the firm had treated the numbers. Journalists were given separate one-to-one briefings.

"We went though a lot of detail and it's now a non-issue, as it always was," says Mr Aldridge. The simple fact is that Capita writes off bid costs on a monthly basis irrespective of whether it wins or loses. To avoid any gripes that there had been shenanigans when the company was carved up into five rather than four divisions, a full audit trail was proffered. Mr Aldridge was also able to point out that, unlike its rivals, Capita did not bid for vastly complex government-sector Private Finance Initiative deals. Nor does the group have any off-balance-sheet special-purpose vehicles.

Where there was leeway in accounting for some items, Capita explained it had opted for arch-conservatism. It had chosen to forgo manoeuvres that would have appeared to have improved its bottom line, temporarily, by between £8m and £10m ($12m-15m). Says Mr Aldridge: "We are very open. Analysts and fund managers have ready access to senior management—phone when you like." Glasnost helped: the Capita share price bounced up around 3 percentage points despite a falling market on the day when it announced it would explain the fine detail of its accounts.

that there is one true figure that reveals how companies perform is a myth."

Culture counts

In any case, corporate governance is about much, much more than the accuracy of the balance sheet. Indeed, except in cases of rudimentary fraud, the balance sheet is just an output of manifold structural and strategic decisions across the entire company, from stock options to risk management structures, from the composition of the board of directors to the decentralisation of decision-making powers. To recall the OECD definition—*"corporate governance is the system by which business corporations are directed and controlled"*—the prime responsibility for good governance must lie within the company rather than outside it.

The EIU survey backs up this

Whistle while you work

Principal barriers to the implementation of proper corporate governance policies within companies

% of respondents choosing as highest or second-highest barrier

Cultural and managerial hostility to whistleblowing on dubious practices	51
Increased focus from shareholders and investors on operating cashflow measures rather than earnings per share	34
Lack of financial understanding on the part of senior executives and the board	30
Lack of financial understanding on the part of line managers and middle managers	27
Lack of business understanding on the part of external auditors	26
Lack of business understanding on the part of the board	23
Technology constraints make it difficult to get a decent integrated picture of the financial accounts quickly	21
Cost of implementing and communicating corporate governance policies throughout the organisation	20

Source: Economist Intelligence Unit online survey, July 2002.

viewpoint. Asked to rank the most significant barriers to improved corporate governance, executives selected cultural or managerial hostility to whistleblowing (chosen by 51% of respondents as the most significant or second most significant barrier), followed by an increased focus on the part of shareholders and investors on operating cashflow measures rather than earnings per share (34%) and a lack of financial understanding on the part of senior executives and the board (30%). Interestingly, cost was not perceived to be an especially significant barrier. Of the three top barriers, two relate directly to individual company culture and structure, and the effects of the other can also be mitigated by good internal governance.

Defining good governance precisely is difficult, of course. In the Economist Intelligence Unit survey, respondents were asked to identify the main remedies that would have helped prevent the Enron debacle. The key imperatives chosen were the following: full disclosure of off-balance-sheet transactions (57%), greater powers for the audit committee (48%) and regular rotation of external auditors (46%). Yet mandatory rotation of external auditors serves to reduce the

discretionary powers of audit committees. Accountants also point out that rotation weakens auditors' understanding of the business.

What's more, a key lesson from the Enron experience, where the board was an exemplar of best practice on paper, is that governance structures count for little if the culture isn't right. As Tom Tierney, a former managing partner of Bain, a consultancy, has explained, "Culture is what determines how people behave when they are not being watched."

Graeme Musker, the company secretary, describes how AstraZeneca, a pharmaceuticals company, recently conducted an exercise asking, could what happened at Enron happen here? "We came to the conclusion that these are radically different companies with different cultures." Even so the company made a few tweaks to its processes (see box, page 10).

Instilling the right kind of corporate culture is the stuff of management bestsellers—there are no easy answers. But self-evidently, CEOs need to lead by example. Lawrence Weinbach, CEO of Unisys, an IT services company, told a recent meeting of leading American chief executives: "Once you as CEO go over the line, then people think it is okay to go over the line themselves."

As for the composition of the board, members feel free to engage in what has been described as a role of "constructive dissatisfaction" by facilitating regular meetings from which executive directors absent themselves. Top management must also grasp that directors' independence can be compromised by "soft conflicts" such as significant charitable contributions to a favourite institution, the award of consultancy contracts to associated companies or the employment of board members' children.

As for the composition of the board, members do not need to have specialist finance or risk expertise to play an effective governance role. The task for the board is rather to understand and approve both the risk appetite of a particular company at any particular stage in its evolution and the processes for monitoring risk. If the management team proposes changing that radically—for example, by dramatically gearing up the balance sheet, by switching the portfolio of assets from low to high risk, or by engaging in off-balance-sheet financial transactions that inherently alter the volatility of the business and its exposure to uncertainties—the board should be quite willing to exercise a veto. Where there is a proposal for shifting the level of risk, the board has the right to have the rationale explained and the obligation to reject the proposal if need be.

Better practice

Culture is necessary but not sufficient to ensure good corporate governance. The right structures, policies and processes must also be in place. AstraZeneca, a pharmaceuticals company, made one or two tweaks following a recent review of its governance practices, for instance. In future, outside auditors will not be awarded consulting contracting work that they will subsequently have to audit. And any substantial consultancy contract, of $500,000 or above, will have to be expressly approved by the audit committee. AstraZeneca is also going to demand the rotation of audit partners—either every five or seven years.

But if any institution, inside or outside the company, deserves scrutiny, it is the board of directors. According to the Economist Intelligence Unit survey, 44% of respondents say the board of directors has primary responsibility for corporate governance. Yet asked to assess the understanding that non-executive directors had of their business, 28% thought they possessed only a satisfactory understanding and 14% thought their understanding was unsatisfactory or poor. More worrying still, when respondents were asked about the confidence they had in various institutions to uncover financial irregularities, the board received the fewest votes of complete confidence.

Up to scratch?
What level of understanding of the business do non-executive board directors have?
% of respondents

An excellent understanding	12
A good understanding	44
A satisfactory understanding	28
An unsatisfactory understanding	10
A poor understanding	4
Other	2

Source: Economist Intelligence Unit online survey, July 2002.

Swiss Re is one company to have realised the value of the board. A decade or so ago, the board was sometimes viewed from inside the company as the "advance guard of the enemy—things were hidden from it", according to Peter Forstmoser, current chairman of the reinsurance giant. "We have witnessed a real change. Today we have sound strategy and good information flow with proper transparency within the company."

And the board itself has come under closer scrutiny. As Mr Forstmoser explains, "Even two or three years ago not much attention was paid to the performance of non-execs. You selected good people and there were hardly any checks on performance. Now every year the board has a meeting dedicated to an assessment of how the board itself has performed in the past 12 months." A next step may be to devise a way to monitor the performance of individual non-executive directors and to bring in outsiders to coach them where necessary.

The price of safety

Just below the surface of the debate on how to improve corporate governance, untouched by the media and the politicians, flows a riptide of controversy about the relationship between innovation and conservatism, governance and growth.

The optimist's view is that governance is not a burden to be tolerated, but a positive force to help businesses become and stay good. Dominique Thienpont of the European Commission's financial markets unit asserts that well-run companies with sound governance "outperform their indices".

But others see a stark choice in the wake of Enron between companies that are accountable and those that are agile. Writing in the context of the debate about loose, innovative companies versus tight, structured firms, Bill Weinstein, professor at Henley Management College, argues, "We may now be caught with a real dilemma—not a situation in which we can waffle about 'balance' between loose networks that deliver more than their core competencies and identifiable units with strict lines of accountability."

Respondents to the EIU survey break into opposing camps. Asked to evaluate the impact of strict corporate governance policies on their business, 45% of the executives surveyed thought that M&A deals would be negatively affected because of the lengthening of due-diligence procedures, and 38% thought it would have a positive impact. Thirty-six per cent thought the ability to take swift and effective decisions would be compromised, against the 34% who thought decision-making of this type would improve.

No doubt, corporate governance would be made a lot simpler if companies avoided risk altogether. They could, for example, shy away from "exotic" financial instruments and transactions with unduly opaque structures. But what counts as exotic in this context lies very much in the eye of the beholder. Forty years ago, a national airline that leased rather than owned its fleet would have looked odd. Today's investors may accept securitisation but look askance at companies that heavily exploit instruments such as collateralised debt obligations (which apportion debt default risks in arcane ways).

Defining where the real boundaries of acceptability lie is a formidable task (though one possible test would be whether the CEO can come up with a plain man's rather than sophist's explanation of what is being done and can say, not that "we have an arguable case in law", but rather that in terms of general business principles this is a reasonable way of doing things). But it

Mixed message
The impact of strict corporate governance on business
% of respondents

	Negative	*No impact*	*Positive*
The ability to form new alliances and partnerships with outside entities	18	44	38
The ability to undertake innovative activities such as corporate venturing or spin-offs	25	40	33
The ability to find new and legitimate means of reducing financial risk	24	35	40
The length of due-diligence procedures during M&A transactions	45	18	38
The ability to take swift and effective decisions	36	29	34

Source: Economist Intelligence Unit online survey, July 2002.

is formidable precisely because companies, and their shareholders, have a legitimate interest in testing those boundaries. "You have to accept risks," says Helmut Maucher, honorary chairman of Nestlé. "Those who avoid them are taking the biggest risk of all."

The power of information

The corporate governance debate is a far more subtle one than the one played out in the newspaper pages might suggest. Tight governance can protect firms and investors from fraud, error and undue risk, but it can also threaten agility and innovation. Yet regulators, the media and the public are uncomfortable with the notion that accounting and governance are a legitimate area of discretion. The solution to the dilemma lies in transparency about a company's governance policies.

As long as key players within the company understand and approve governance policies, and as long as investors and shareholders are then given clear and accessible information about those policies, the market can be allowed to do the rest, assigning an appropriate risk premium to companies that have too few independent directors or an overly aggressive compensation policy, or cutting the costs of capital for companies that adhere to conservative accounting policies.

That's the theory. But research for this white paper has found that leading firms worldwide perform poorly when it comes to transparency. The Economist Intelligence Unit looked at the top ten

Tracking transparency

The Economist Intelligence Unit looked at the top ten firms by market capitalisation in the US, UK, Japan, France and Germany over a three-week period in July 2002. Each company was assessed for the provision and accessibility of information on 29 different governance issues ranging from disclosure on executive pay, information on non-executive directors, retention of auditors and ease of voting at the AGM.

Overall, most firms (two-thirds of the 50 reviewed) offer a separate and easy-to-find section on corporate governance, except in Japan and the US, where such sections were only available on half the websites reviewed. But if you want a record of how often non-executive directors attended board meetings, most of these companies (94%) wouldn't tell you and only two shared the information without making you hunt for over an hour.

Japanese and US companies were worse than their European counterparts at disclosing governance information—at least on their English-language websites. German companies were the best among the bunch. All ten German companies examined made it easy to find out when the next annual general meeting was, provided a separate section on their websites about how they govern their companies and made it easy to discover when the last quarterly results were released. Admittedly basic, but few other companies in other countries disclosed even this much. German companies were also better than others at disclosing when the last meetings with analysts were held, what risks the companies faced and what accounting policies they followed.

Opacity rules

Average corporate transparency scores in each country*

	US	UK	Germany	France	Japan
Average score	0.5	1.1	1.3	1.2	0.4

* Ten companies in each country were marked for transparency on 29 items of governance information, according to the following scale:

0 = information not there;
1 = information there but hidden;
2 = information easily found but hard to understand/incomplete;
3 = information easily found, understandable and complete.

Note: Full research results are available from the Economist Intelligence Unit on request. Please contact Andrew Palmer on andrewpalmer@eiu.com

Source: The Economist Intelligence Unit.

firms by market capitalisation in the US, UK, Japan, France and Germany, and assessed the degree of openness they displayed in making available information on various corporate governance issues.

The results were not encouraging. Governance information—including CEO searches, selecting their directors and auditors, or shareholder voting rights—is often either buried in or missing from corporate websites and annual reports (see box, page 13). Details of accounting policy are in any case inherently daunting for the layperson—here perhaps lies the future for the audit profession, with the role of the auditors increasingly geared to making the inner workings of the balance sheet transparent.

Of course, even transparency has its limits. Swiss Re's chairman, Mr Forstmoser, cheerfully admits that he would not disclose the reserve set aside for the multi-billion-dollar World Trade Center claim, now subject of litigation. And some would argue that transparency puts the burden of responsibility for identifying poor governance practices back on the investor rather than the company itself. But after a decade when investors were happy to get rich rather than to question soaring stock values, it doesn't hurt to remember that the shareholder has the ultimate responsibility for the decision to invest—and that corporate transparency is crucial to enabling an informed decision.

Executives have a clear responsibility consciously to define and implement corporate governance policies that offer a decent level of reassurance to employees and investors. Thereafter, disclosure is the most effective way for companies to resolve the thorny tensions that do exist between vision and prudence, innovation and accountability.

Appendix: Executive survey results

As part of the research for this white paper, the Economist Intelligence Unit conducted an online survey of 115 senior executives worldwide into their views on corporate governance. We would like to thank everyone who participated in the survey for their time and insights.

Respondent demographics

% of respondents

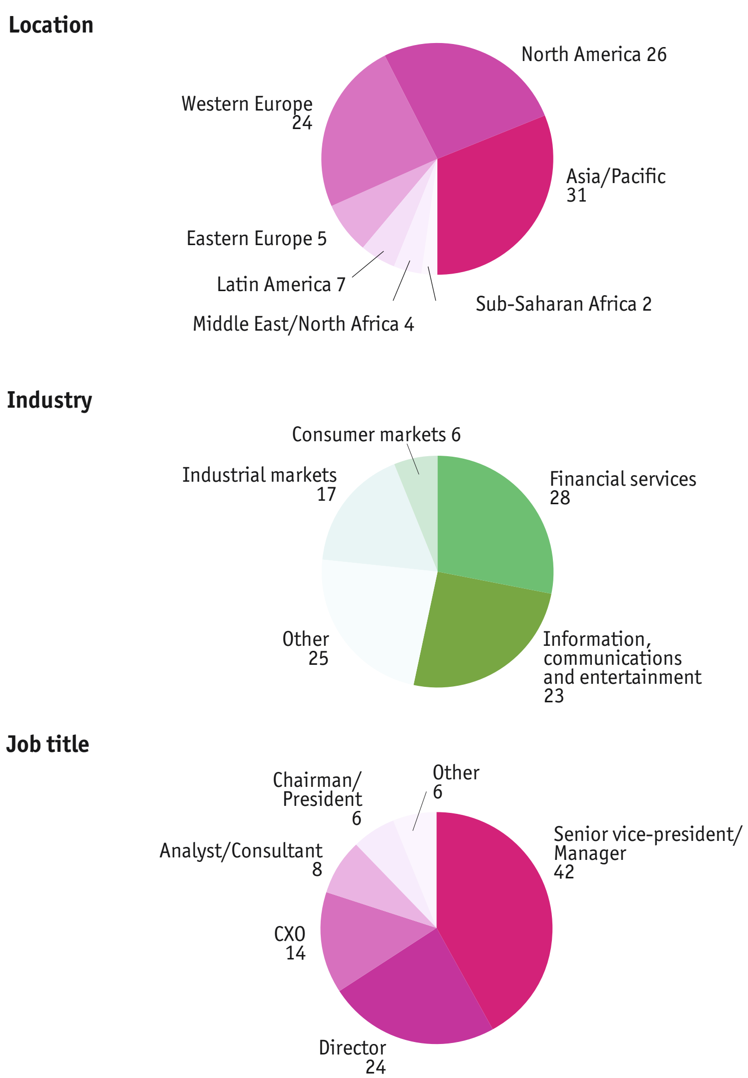
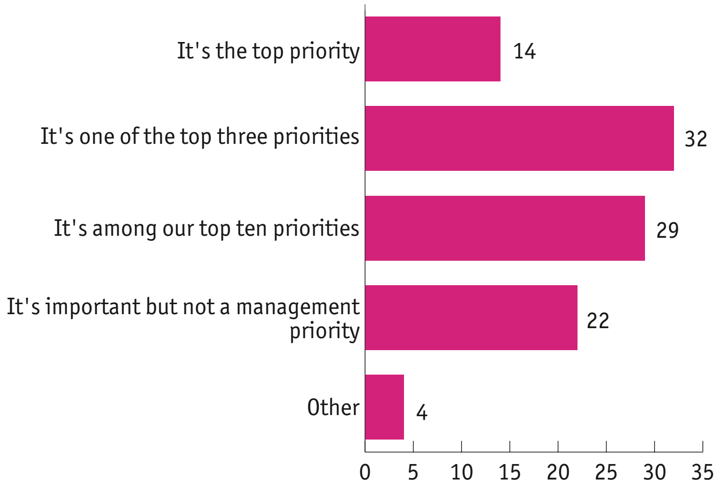


Figure 1
Where does corporate governance rate in the list of current priorities within your organisation?
% of respondents



Source: Economist Intelligence Unit online survey, July 2002.

Figure 2
Who has primary responsibility for corporate governance issues within your organisation?
% of respondents

Source: Economist Intelligence Unit online survey, July 2002.

Figure 3

How confident are you that the following type of incident could not happen at your firm?

% of respondents

	1 Complete confidence	*2*	*3*	*4*	*5 No confidence at all*
Enron (ie systemic governance failures)	45	33	18	3	2
Allied Irish Banks (ie exposure to actions of rogue employee)	24	40	25	11	0
Equitable Life (ie exposure to unexpected market or macroeconomic movements)	12	31	36	18	3
Merrill Lynch (ie conflicts of interest between revenues centres in the same company)	28	28	25	13	5
Withholding of sensitive information from independent directors	21	37	19	22	1

Source: Economist Intelligence Unit online survey, July 2002.

Figure 4

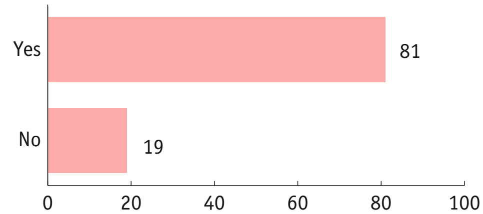
Which of the following pose the greatest threat to the share price of your organisation?

% of respondents

	1 Most threatening	*2*	*3*	*4*	*5*	*6*	*7*	*8 Least threatening*
Unethical behaviour by employees	11	9	18	14	8	13	13	13
Credit risk	3	13	12	16	13	21	10	13
Market risk (ie a downturn in market conditions)	19	20	20	10	15	10	4	3
Operational risk (ie IT or logistics failures)	5	13	22	21	14	10	11	2
Reputational risk	15	7	13	20	13	11	4	7
A failure to innovate as fast as competitors	13	16	14	18	13	10	10	7
Poor financial reporting and disclosure practices, including communications with analysts	8	15	10	14	14	12	19	8
A shortage of top-quality senior management talent	15	22	26	9	5	8	9	4

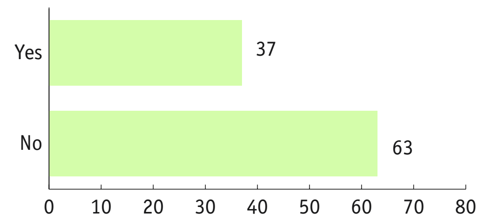
Source: Economist Intelligence Unit online survey, July 2002.

Figure 5
Does your firm have a code of ethics?
% of respondents



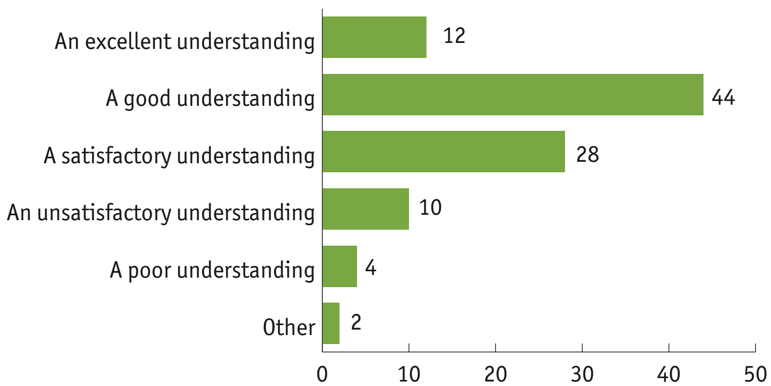
Source: Economist Intelligence Unit online survey, July 2002.

Figure 6
Has it been revised in the past 12 months?
% of respondents



Source: Economist Intelligence Unit online survey, July 2002.

Figure 7
In your view, what level of understanding of the business do non-executive board directors have?
% of respondents

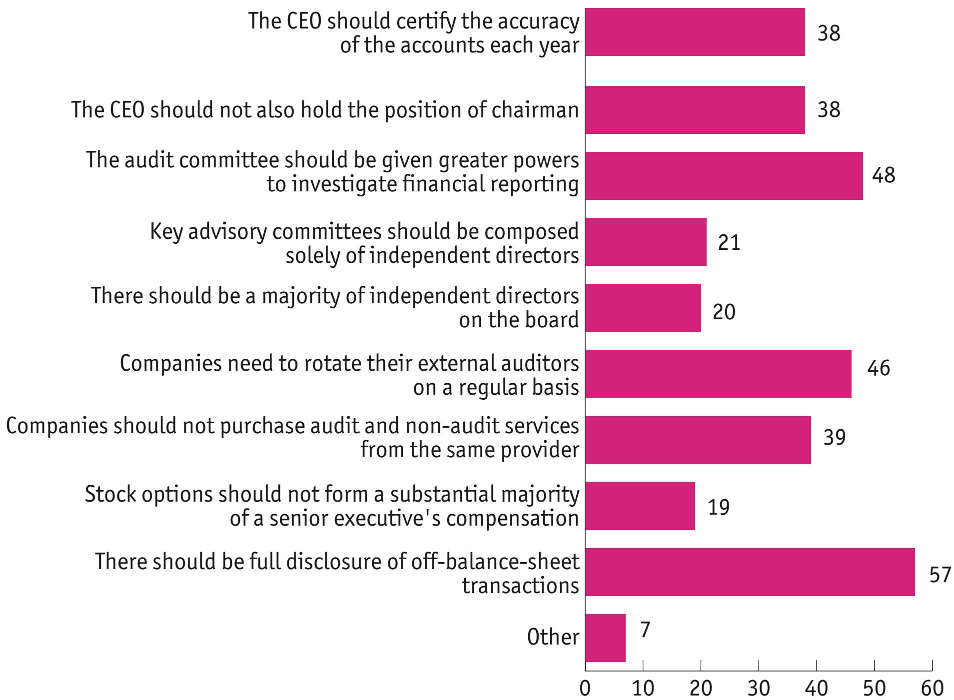


Source: Economist Intelligence Unit online survey, July 2002.

Figure 8

What are the principal lessons other companies can learn from the collapse of Enron?

% of respondents

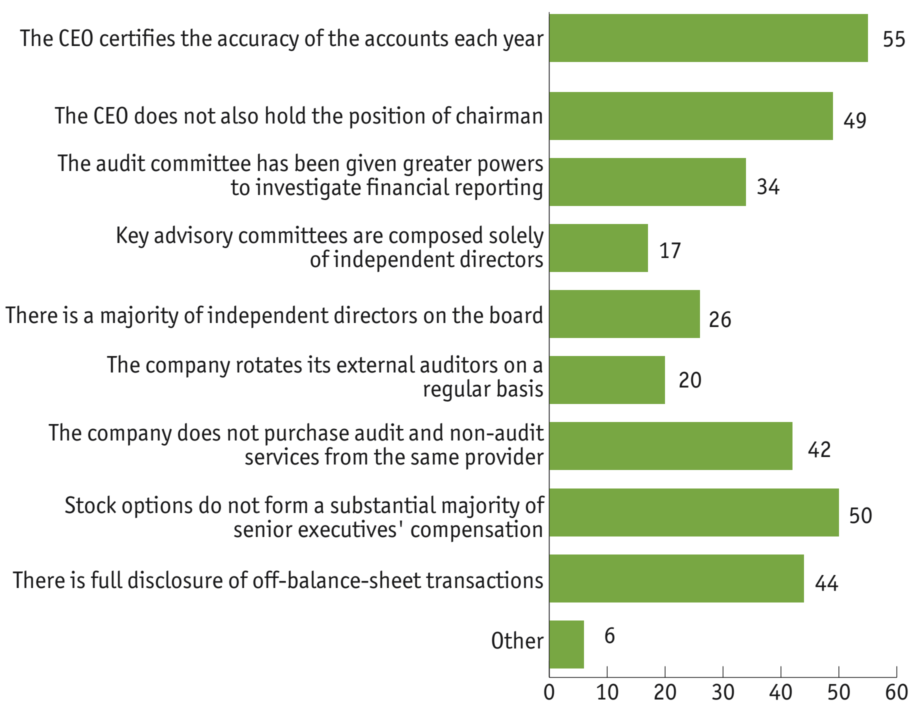


Source: Economist Intelligence Unit online survey, July 2002.

Figure 9

How many of these prescriptions does your organisation put into practice?

% of respondents



Source: Economist Intelligence Unit online survey, July 2002.

Figure 10

How much confidence do you have in the following to uncover irregularities in financial reporting within your organisation?

% of respondents

	1 Complete confidence	*2*	*3*	*4*	*5 No confidence at all*
Senior management	26	37	24	11	3
The board of directors	16	33	23	19	8
The CFO	33	37	17	12	1
The audit committee	16	39	25	12	4
External auditors	18	42	29	11	0
Internal auditors	19	38	29	10	0

Source: Economist Intelligence Unit online survey, July 2002.

Figure 11

How much confidence do you have in the following to rectify irregularities in financial reporting within the organisation if they are uncovered?

% of respondents

	1 Complete confidence	*2*	*3*	*4*	*5 No confidence at all*
Senior management	41	40	13	6	1
The board of directors	33	40	20	6	1
The CFO	42	31	18	8	0
The audit committee	25	34	23	13	1
External auditors	22	33	27	14	4
Internal auditors	19	31	26	13	5

Source: Economist Intelligence Unit online survey, July 2002.

Figure 12

What are the principal barriers to the implementation of proper corporate governance policies within companies?

	1 Most significant	*2*	*3*	*4*	*5*	*6*	*7*	*8 Least significant*
Technology constraints make it difficult to get a decent integrated picture of the financial accounts quickly	13	8	18	15	8	12	12	15
Lack of financial understanding on the part of senior executives and the board	9	21	23	17	13	5	7	5
Lack of financial understanding on the part of line managers and middle managers	5	22	17	24	19	8	1	4
Lack of business understanding on the part of the board	10	13	16	16	15	13	10	7
Lack of business understanding on the part of external auditors	4	22	19	15	1	12	8	5
Cost of implementing and communicating corporate governance policies throughout the organisation	7	13	11	17	13	14	15	11
Increased focus from shareholders and investors on operating cashflow measures rather than earnings per share	20	14	13	15	9	11	10	5
Cultural and managerial hostility to whistleblowing on dubious practices	19	32	8	12	7	6	5	8

Source: Economist Intelligence Unit online survey, July 2002.

Figure 13

What potential impact does the imposition of strict corporate governance procedures have on the following aspects of business?

% of respondents

	1 Substantially negative impact	*2*	*3 No impact*	*4*	*5 Substantially positive impact*
The ability to form new alliances and partnerships with outside entities	4	14	44	26	12
The ability to undertake innovative activities such as corporate venturing or spin-offs	4	21	40	20	13
The ability to find new and legitimate means of reducing financial risk	2	22	35	25	15
The length of due-diligence procedures during M&A transactions	10	35	18	26	12
The ability to take swift and effective decisions	7	29	29	19	15

Source: Economist Intelligence Unit online survey, July 2002.

Figure 14

Which of the following measures does most in your view to ensure corporate transparency for shareholders?

% of respondents

	1 Most impact	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9 Least impact*
Global adoption of International Accounting Standards in financial reporting	25	26	19	9	9	4	4	4	2
Mandating listed companies to adopt and publish corporate governance guidelines and a code of business conduct and ethics	16	18	17	15	15	4	7	4	4
Requirement for the reporting of results to uniform accounting guidelines before any reference to pro forma or adjusted information	19	23	23	9	10	6	4	5	1
Quicker disclosure of insider-trading by company officers	20	20	20	12	12	5	4	2	4
Requirement that reasons for and impact of accounting policies be included in annual reports	16	16	22	19	15	5	3	3	2
CEO to certify all statements and reporting of accounts to shareholders	22	13	13	14	17	6	5	7	2
Requirement for the inclusion of an Operating and Financial Review in the annual report	19	19	19	18	8	5	7	1	1
Use of scenarios and probabilistic forecasts in forward-looking financial statements	6	11	21	12	15	10	12	6	4
Financial results to be discussed at press conference with media and analysts together in the audience	10	12	14	11	18	5	10	8	10

Source: Economist Intelligence Unit online survey, July 2002.

Figure 15

How many of these measures does your company implement?

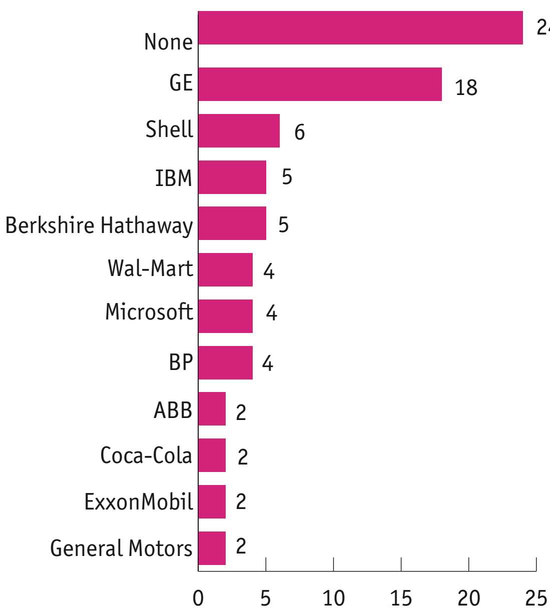
% of respondents

Source: Economist Intelligence Unit online survey, July 2002.

Figure 16

Which *Fortune* 500 company stands out in your view as a leader in the field of corporate governance and transparency?

% of respondents



Source: Economist Intelligence Unit online survey, July 2002.

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