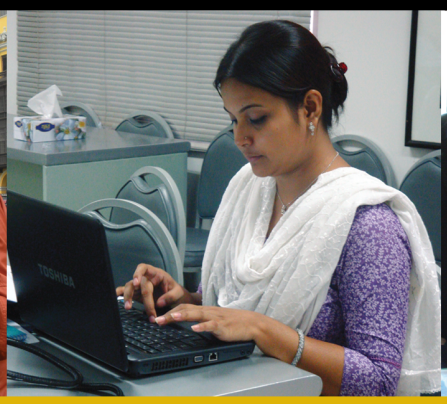
Who's Running the Company?

A guide to reporting on corporate governance



ICFJ
International Center for Journalists
Advancing Quality Journalism Worldwide

Global Corporate Governance Forum

IFC
International Finance Corporation
World Bank Group

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A guide to reporting on corporate governance

Global Corporate Governance Forum
and the International Center for Journalists

FOREWORD

To report professionally, business journalists today need a solid understanding of how modern companies are run, the conditions necessary for their success and the challenges and issues that confront them. Specifically, journalists who value good corporate governance practices will earn their peers' respect and build trusted working relationships with the companies they cover.

Since the launch of the Media Training Program in 2007, the Global Corporate Governance Forum has conducted various training workshops for journalists in the Middle East, Africa, South Asia, Latin America, Central Asia, and East Asia, most of them in partnership with Thomson Reuters Foundation and Agence France-Presse.

During these training events, we found many examples of business journalists reporting on corporate governance practices without necessarily being aware of it. The Forum's work with the media constitutes an important part of the efforts to raise awareness of the issues and advance good corporate governance practices in emerging markets and developing countries. This effort is being made in cooperation with IFC, a member of the World Bank Group.

Our program's objective is to draw on journalists' unique ability to disseminate information on corporate governance to the business community and the wider public, and for journalists to make readers aware of company activities in ways that can have a significant impact not only on their shareholders but on society. Through their investigations and insight, journalists can show what happens when companies are poorly governed. Journalists can also illustrate how companies that abide by best practice not only perform better but are more resilient in a difficult economy.

In addition, more probing, more insightful business reporting differentiates one news outlet from another and draws in the more sophisticated and informed business audience seeking information and news that is well presented, thoughtful and constructive.

"If you're ignoring corporate governance in your coverage of companies, you are only giving your readers part of the story," advises Cristina Sevillano del Aguila of Stakeholders Magazine (Peru). "For investors, too, they need independent information beyond what companies provide to be effective in rectifying wrongdoing. That information must be written so that it's easy to understand and relevant to your audience's interests."

Partnering with the International Center for Journalists (ICFJ) in the production of this Guide draws on its extensive experience with journalists around the world, particularly in difficult markets. While the Forum has offered its expertise in corporate governance, ICFJ has ensured that the Guide is suitably tailored to the requirements of a business reporter wanting to learn about key elements of corporate governance and what makes an interesting story. They not only understand what a journalist needs but also how this should be conveyed through our training programs. ICFJ offers extensive resources and expertise far beyond what is provided in this Guide.

This Guide builds on the Forum's and IFC's experience in providing training for business reporters, and its work in producing internationally acknowledged corporate governance capacity-building tools and knowledge materials. It covers important topics on corporate governance and provides examples and case studies on investigative journalism based on contributions from experienced journalists and drawing on our own observations.

While the Guide is not intended to be a definitive resource on corporate governance, it does set out some very useful principles for business reporters in emerging markets and developing countries. The section "About the Guide" explains its use, purpose and function.

As is the case with all of the Forum's work, the Guide's production involved extensive collaboration with many people and organizations. Their commitment to this effort is gratefully appreciated in the "Acknowledgements" section.

Philip Armstrong
Head, Global Corporate Governance Forum

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ACKNOWLEDGEMENTS

Who's Running the Company? A Guide to Reporting on Corporate Governance was accomplished thanks to the efforts and active participation of many around the world.

The Global Corporate Governance Forum especially would like to thank **Margie Freaney**, main writer, and the following colleagues, peer reviewers, members of the Forum's Private Sector Advisory Group, and the International Center for Journalists (ICFJ) for their contributions to the media Guide (by alphabetic order):

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ABOUT THE GUIDE

This Guide is designed for reporters and editors who already have some experience covering business and finance. The goal is to help journalists develop stories that examine how a company is governed, and spot events that may have serious consequences for the company's survival, shareholders and stakeholders.

Topics include the media's role as a watchdog, how the board of directors functions, what constitutes good practice, what financial reports reveal, what role shareholders play and how to track down and use information shedding light on a company's inner workings.

Journalists will learn how to recognize "red flags," or warning signs, that indicate whether a company may be violating laws and rules. Tips on reporting and writing guide reporters in developing clear, balanced, fair and convincing stories.

Three recurring features in the Guide help reporters apply "lessons learned" to their own "beats," or coverage areas:

Reporter's Notebook: Advice from successful business journalists
Story Toolbox: How and where to find story ideas
What Do You Know? Applying the Guide's lessons

Each chapter helps journalists acquire the knowledge and skills needed to recognize potential stories in the companies they cover, dig out the essential facts, interpret their findings and write clear, compelling stories:

- What corporate governance is, and how it can lead to stories. (Chapter 1, What's good governance, and why should journalists care?)
- How understanding the role that the board and its committees play can lead to stories that competitors miss. (Chapter 2, The all-important board of directors)
- Shareholders are not only the ultimate stakeholders in public companies, but they often are an excellent source for story ideas. (Chapter 3, All about shareholders)
- Understanding how companies are structured helps journalists figure out how the board and management interact and why family-owned and state-owned enterprises (SOEs), may not always operate in the best interests of shareholders and the public. (Chapter 4, Inside family-owned and state-owned enterprises)
- Regulatory disclosures can be a rich source of exclusive stories for journalists who know where to look and how to interpret what they see. (Chapter 5, Toeing the line: regulations and disclosure)
- Reading financial statements and annual reports — especially the fine print — often leads to journalistic scoops. (Chapter 6, Finding the story behind the numbers)
- Developing sources is a key element for reporters covering companies. So is dealing with resistance and pressure from company executives and public relations directors. (Chapter 7, Writing and reporting tips)

Each chapter ends with a section on Sources, which lists background resources pertinent to that chapter's topics. At the end of the Guide, a Selected Resources section provides useful websites and recommended reading on corporate governance. The Glossary defines terminology used in covering companies and corporate governance topics.

Notes: All figures are in U.S. dollars.
The terms "company," "corporation" and "enterprise" are used interchangeably to refer to a business entity.

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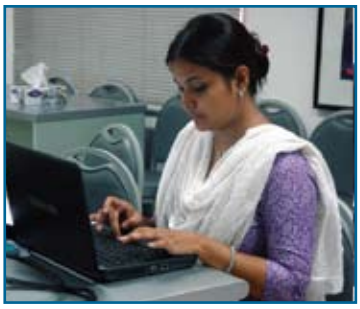

What's good governance, and why should journalists care?

"Poor corporate governance has ruined companies, resulted in directors being sent to jail, destroyed a global accounting firm and threatened companies and governments."

— The Economist (Essentials for Board Directors)

Good journalists can sniff a good story even in the most innocuous press release. But the phrase "corporate governance" doesn't set off any alarm bells. However, these words will*: fraud, theft, waste, incompetence, double-dealing, nepotism, abuse of power, embezzlement, conflict of interest, favoritism, corruption*.

These terms light a fire under journalists, because they may lead to exclusive, groundbreaking stories that are the essence of good journalism.

Not all corporate governance stories are about scandals, however. They can be about heroes and visionaries, about brilliant ideas and charismatic leaders, about men and women who build great fortunes by giving the world new products and services that improve lives.

Governance, at its heart, provides the direction for a company or state-owned enterprise (SOE). Guidelines, standards and best practices established worldwide define what constitutes good governance, and a savvy business journalist quickly learns the difference between good governance and bad. Both can lead to great stories.

In this Guide, you will learn what constitutes good and bad governance; how to spot red flags; and where to find information about what company leaders are doing. You will find stories written by international reporters and tips and techniques for making stories clearer and more compelling for the audience.

Corporate governance describes the structures and procedures to direct and control companies, and the processes used by the board of directors to monitor and supervise management in discharging the board's accountability to shareholders for the running of the company and the performance of its operations.

Corporate governance stories essentially are about people: shareholders who want to change company policies; struggles between directors — who are charged with setting the company's strategy and policy — and managers, who might have different ideas. Transparency and accountability play a large role in such stories, along with actions by regulators, stock exchanges, shareholders and stakeholders. Journalists have a role in transparency by highlighting significant noncompliance. Without transparency, the system cannot work well.

"Corporate governance is about shining a light through the whole organization," says Roshaneh Zafar, managing director/CEO of Kashf Microfinance Bank Ltd. in Pakistan.

For a short description of corporate governance, see "Improving Business Behavior: Why We Need Corporate Governance," from the Organization for Economic Cooperation and Development (OECD): http://bit.ly/J11k9R

Many journalists already report on corporate governance without realizing it. Stories about changes in leadership or new acquisitions are about corporate governance — even if the words are never mentioned.

Journalists' primary interest is in the stories they can unearth by digging into a company's strategy, oversight and transparency. But good governance does have a wider impact, documented by research, because it:

- Encourages investment
- Enhances investor confidence/interest, which

lowers a company's cost of borrowing money or raising capital
- Boosts companies' competitiveness
- Better equips companies to survive economic crises
- Makes corruption less likely
- Ensures fairness to shareholders
- Forms part of the overall checks and balances on big business that ultimately benefit society

Research shows that growth is particularly strong for those industries most dependent on external finance. The quality of corporate governance can also affect firms' behavior in times of economic shocks. Well-governed companies have less volatile share prices in times of crisis.

For an overview on the influence of good governance, see "Focus 10: Corporate Governance and Development": http://bit.ly/M2shli

Good corporate governance can help family-owned or -controlled companies survive succession battles that doom most such companies, says Joseph Fan, a finance professor and co-director of the Institute of Economics and Finance at the Chinese University of Hong Kong (http://bit.ly/M2txF7).

How journalists act as watchdogs

Exposing practices that lead to widespread shareholder losses and potentially affect the economy is part of the media's role as watchdog. It's the journalist's job to pay attention to companies' leadership and ask whether directors and management are making the right decisions, and how their actions connect to their company duties.

These questions can result in stories that serve an extremely varied audience, which includes consumers, investors, taxpayers, business leaders, directors, regulators, policymakers and customers.

Learning to recognize whether directors are acting in the shareholders' best interests and the company's long-term interests is the reporters' first step in digging below the surface of the companies they cover. Directors and managers who don't follow accepted practices, when others do, should be asked why. (See Chapter 2 for more details on how boards direct strategy and protect shareholder interests, and more on how boards and management interact.)

Defining and recognizing good governance

But what constitutes good governance? More than 70 countries now have codes or guidelines that spell out the principles that directors and managers should follow to achieve governance goals. These usually are not mandated by law, and are designed to encourage voluntary compliance. The codes lead to definitions of "best practices," which aim to define specific policies and procedures that foster good governance.

Companies that deviate significantly from the codes' recommendations deserve special scrutiny, and may produce good investigative stories. Highlighting such noncompliance is one of the ways that media can focus attention on companies that may even be operating illegally.

Compare other countries' governance codes with that of your own country: http://bit.ly/IttIHR

Learning to recognize whether directors are acting in the shareholders' best interests and the company's long-term interests is the reporters' first step in digging below the surface of the companies they cover.

For example: Most codes call for a board to have several independent directors. "Independent" essentially means a person who is free of material relations with the company's management or others involved with the company. Unclouded by conflicts of interest, such a director can make decisions based on the potential benefits for the company and its shareholders.

A board stacked with friends or relatives of the top managers is less likely to act as a check and balance in serving shareholders' interests.

Companies worldwide often have dominant shareholders who are members of the same family. This is particularly common in emerging markets. Often, the family dominates the board and management, perhaps exerting influence through special shares that control voting power, even though the family may own only a small percentage of total shares.

Also common in emerging markets are enterprises that are either owned by the state or essentially controlled by the state through the make-up of the board and management. This can lead to decisions being made for political reasons rather than for the benefit of shareholders.

Governance issues drive major stories

Family-owned companies are the bedrock of any successful economy. Examples include Ford Motor Co. in the United States, Tata Group in India and Sabanci Holding in Turkey. But family-owned companies also may have serious corporate governance lapses.

At India's Satyam Computer Systems Ltd., for example, family members attempted to divert assets into two other family-owned companies.

As the Times of India reported, *"The Satyam scandal came to light on January 7, 2009, with a confession from the company's founder B Ramalinga Raju that he had been cooking the firm's books for several years." In his letter to the board revealing the fraud, Raju states that, "What started as a marginal gap between actual operating profits and ones reflected in the books of accounts continued to grow over the years. It has attained unmanageable proportions...." Later, he describes the process as "like riding a tiger, not knowing how to get off without being eaten."*

It was later determined that Satyam had violated several laws that protect shareholders, and that are designed to prevent and penalize efforts to divert company assets from shareholders to the benefit of the perpetrators.

For more on the Satyam case, see:
http://reut.rs/lcj4hL
http://scr.bi/lA3vm7
http://bit.ly/HEcrLX

Anticipating risk

One best practice cited in corporate governance codes requires corporate leadership to anticipate and manage risks the company might face. Companies take risks to generate returns. The board is responsible for ensuring that all business risks are identified, evaluated, disclosed and managed.

The obligation to manage risk became a key issue after the 2011 earthquake and tsunami in Japan that ravaged the Fukushima Dai-Ichi nuclear station, creating a public health crisis.

Why, critics and journalists asked, did directors of the Tokyo Electric Power Company Inc. (TEPCO), the publicly traded Japanese energy company, fail to prepare adequately for risks that had been previously identified? Why weren't there any independent board members or a risk committee? Why weren't there appropriate policies to identify the risks and the steps for mitigating those risks should a nuclear mishap occur?

"TEPCO … couldn't have predicted that the tsunami would hit, but it could have been better prepared for such an event to take place," research analyst Nathanial Parish Flannery wrote, noting that outside experts had warned that the nuclear facility was at risk of being damaged even by a mid-sized tsunami.

But these criticisms and questions mostly came after the fact.

Among tools that journalists can use to assess companies are corporate governance scorecards, which try to help companies judge how well they comply with good governance principles and practices. In many countries, these scorecards are issued annually, and provide ideas for stories.

For example, a corporate governance scorecard for Vietnam in 2011, released by the World Bank's private arm, the International Finance Corporation (IFC), urged improvement in protecting shareholders' rights and treatment. The scorecard studied corporate governance practices at the 100 largest companies listed on the Hanoi and Ho Chi Minh City exchanges.

See a story on the scorecard at:
http://bit.ly/HEcwiH

And a link to the scorecard itself:
http://bit.ly/I73s2j

Codes and scorecards provide a handy checklist for journalists to determine whether companies they cover follow generally accepted best practices in their countries.

(See Story Toolbox in this chapter for story ideas based on codes and scorecards.)

Effects of governance failures

When a company suffers a major governance failure, whether it's due to an ethical or accounting violation, faulty risk management and oversight or ineffective board decision-making, the effects can be far-reaching.

The share price can fall sharply, affecting shareholders and sometimes even the industry sector in which the company operates. The company might ultimately fail, leading to job losses and other harmful consequences for the region where it operates.

In some extreme cases such as government bailouts, taxpayers can be left repaying the costs. The government bailout of Bank of Moscow in 2011 — reputedly because of questionable loans — cost $14 billion, equivalent to 1 percent of Russia's economic output.

The stories are often full of interesting personalities. Reporters may find themselves writing about highly secretive and powerful business families or former state ministers who run their countries' largest corporations. In these stories, the issue of succession — who will take over the reins — is critically important.

The Indian and foreign press followed closely the question of who would replace the 75-year-old Ratan Tata, chairman of Tata Group, the country's largest global conglomerate. The question of succession affects not only the company itself, with its huge impact on the national economy, but 100 Tata subsidiaries that are themselves major drivers of jobs and the economy worldwide.

Once the decision was announced, in November 2011, it set off many speculative stories about the strengths and weaknesses of the new leader — Cyrus Mistry, son of Tata's largest individual shareholder.

Often corporate governance stories are full of intrigue, such as the feud between the Ambanis, two Indian brothers whose dispute over how to divide their late father's Reliance business empire threatened to endanger the country's economy.

See an example of a story about the Ambani brothers at: http://tgr.ph/I73AiI

Know where to look and what to ask

To report on stories such as the Ambani brothers' feud, journalists must know how to recognize signs of change within a company and what questions to ask. This requires intimate familiarity with good corporate governance practices and how directors and management in specific companies operate.

Companies not listed on a stock market — especially family-owned enterprises (FOEs) — are often highly secretive, and many state-owned companies (SOEs) might not keep or release reliable information. When writing about these more secretive enterprises, reporters need to develop sources inside and outside the company. Remem-

Social networking sites, such as Facebook and LinkedIn, may provide unexpected insight, especially through employees' eyes. Blogs, including those by company critics, are another useful tool.

For expert tips on how business journalists can use LinkedIn to find contacts and research company officials, see:
http://bit.ly/lA4ymd

ber that employees, suppliers, competitors and distributors often have insights into companies.

Social networking sites, such as Facebook and LinkedIn, may provide unexpected insight, especially through employees' eyes. Blogs, including those by company critics, are another useful tool. In both cases, journalists must verify all unofficial information and also be aware of personal agendas and grudges that some employees and bloggers might have.

Knowing how to read and analyze financial statements and other company documents and regulators' reports can often lead to stories, even if senior management refuses requests for interviews.

A Wall Street Journal reporter, Jonathan Weil, spent two months studying the subtleties of accounting for energy derivatives, consulting with accounting and derivatives experts and examining the U.S. Securities and Exchange (SEC) filings of Enron Corp., before writing a story in September 2000 that questioned the credibility of the company's stated earnings.

His article did not attract much attention at the time. But some media analysts eventually credited Weil as the first to shine a light on the fraudulent accounting practices that led to the company's implosion and criminal convictions of its top executives in perhaps the greatest corporate scandal in U.S. history.

Skepticism, hard work, good sources pay off

Enron's fraud had been going on for several years before journalists caught even a whiff of it, as Michael J. Borden noted in a study of the role of financial journalists.

When journalists did catch on to what Enron was up to, Borden notes, it was because of "skepticism, hard work, ability to analyze accounting reports, and cooperation with analysts and other experts." Having the know-how to do that kind of rigorous reporting, he says, makes journalists the catalysts that set off legislative and regulatory reactions that lead to reforms.

How do journalists acquire that kind of savvy, short of returning to the university for an advanced accounting degree?

It sometimes takes an expert to spot trouble, and that's why journalists need to develop good sources at all levels.

It was a hedge fund manager who alerted several journalists from prominent foreign publications that managers of the Russian energy company Gazprom were shifting corporate assets to entities controlled by friends and relatives. Eventually, the company's chief executive resigned and Gazprom instituted other reforms.

STORY **TOOLBOX**

Story idea: How do the companies you cover match up with the good governance codes established in your country? Stay on top of any changes in the corporate governance code, which could be a story in itself.

A story also might examine how companies in your country compare with their neighbors in the region when it comes to compliance with good governance practices. Take just one issue: transparency and disclosure. Check the company on these items:

- **Does it have an external auditor? Is the external auditor a recognized national or international auditing firm? Any conflicts of interest?**
- **Do directors disclose their buying and selling of company shares? Do they do so in a timely manner?**
- **How much information does the company disclose about directors' backgrounds, expertise and other board affiliations? From this information, are there any conflicts of interest? Are board directors independent?**
- **How extensive is the company's disclosure on compensation for management and for directors? Is this consistent with other companies' practices?**
- **Are non-executive directors compensated? If not, what is their motivation for serving on the board?**
- **What do companies reveal about their strategy and their foreseeable risks?**

For an example of a story on this topic, see:
http://bit.ly/ljlFaY

> The problem with governance stories is that they are convoluted and complicated. If they weren't so convoluted, shareholders would do something…."
>
> *— Alexander Dyck, professor of finance and business economics at the University of Toronto*

Making the complicated understandable

"The problem with governance stories is that they are convoluted and complicated. If they weren't so convoluted, shareholders would do something…. There's an incentive for the parties engaged in the company to hide and confuse what's going on," according to Alexander Dyck, professor of finance and business economics at the University of Toronto, who has researched the impact of news stories on companies.

That's why it's vitally important for business reporters writing about complicated accounting maneuvers to avoid jargon and present facts in a user-friendly way. Explaining and defining terms, avoiding insider terminology and writing clearly help attract readers and viewers to stories they might otherwise skip as too dense.

Get out in front of the story

Stories about greed and corruption have dominated business coverage in the last decade. But in many cases, journalists have been forced into follow-up mode once a company has already imploded.

That was the case with the Satyam story, where the discovery of massive accounting fraud led to the company's collapse, which was not covered until after the fact.

PricewaterhouseCoopers, the external auditor, approved Satyam's inflated balance sheet figures for several years.

Journalists and other critics later asked whether Satyam's auditors were sufficiently independent and expert, and questioned why auditors did not notice the red flags, which included millions in missing cash.

Just a year before it was awash in scandal, Satyam won a Golden Peacock Award for excellence in corporate governance from the World Council for Corporate Governance. The Council later rescinded the award and complained that the company had failed to disclose material facts.

But Business Week reporter Beverly Behan wrote that the Satyam board was clearly flouting good governance practices. Journalists could have learned by examining the composition of the board that it lacked financial expertise, was only barely independent and failed to meet independently of management — all counter to good governance practices.

As the Satyam case demonstrated, impressive business awards and glossy annual reports are no guarantee that companies are operating legally and ethically.

One of the most sensational business corruption cases continues to unfold in Croatia, as of this writing. Managers and board members of the respected food company Podravka have been embroiled for three years, since 2009, in charges that certain members colluded to use company money to illegally attempt to take over the company by buying its shares and investing in another company.

REPORTER'S NOTEBOOK

"If you know how to read financial statements, it goes a long way to helping any reporter or anybody else not to have to rely on official publications from the people running these companies or the regulators who protect them."

— Jonathan Weil, former Wall Street Journal reporter who wrote first Enron story, now Bloomberg news columnist.

Source: Audit Interview, Ryan Chittum, *Columbia Journalism Review*

Investigative reporting, though, is different. It requires enterprise and ingenuity on the part of the reporter, who is exploring uncharted territory and making new discoveries and connections...

In what press reports called one of the largest cases in Croatian judicial history, seven former company executives and their business partners were charged with defrauding Podravka of at least 54 million euros, and as the case expanded, the country's former deputy prime minister was forced to resign over charges that he, too, was connected with the scheme.

Podravka replaced its management and supervisory boards, but in March 2012, the case continued to make headlines.

Writing about such company practices before the fact, rather than dissecting the causes after a meltdown, is the difference between explanatory reporting — or what some call "archeological" reporting — and investigative reporting. Explanatory reporting reconstructs how and why an event occurred. That kind of journalism can be valuable and instructive. It often follows revelations from regulators or court trials.

Investigative reporting, though, is different. It requires enterprise and ingenuity on the part of the reporter, who is exploring uncharted territory and making new discoveries and connections, not covering ground already traveled by someone else.

As more business journalists become adept at covering companies' inner workings, and probe more deeply, they may recognize and report on irregularities before they explode into scandals. (For websites of organizations that provide training, information and support for investigative reporting, see Chapter 7.) ■

WHAT DO YOU KNOW?

Quick Quiz

1. Why should a board have independent directors?

A. They can take over for executives if necessary.

B. They are able to make decisions free of conflict of interest

C. They do not hold large share positions in the company

2. Who has primary responsibility for risk management in a company?

A. The CEO

B. Board of directors

C. Shareholders

3. Scorecards are useful ways to:

A. Determine whether companies are following good corporate governance practices

B. Figure out which companies' shares are likely to go up

C. Find out which directors serve on multiple boards

Answers: 1. B, 2. B, 3. A

SOURCES *Chapter 1*

Editor's note: The following sources were consulted in the preparation of Chapter 1. Most of the websites are accessible to any reader. Stories in certain publications, such as The Wall Street Journal and the Financial Times, require a subscription for access. The New York Times provides a limited number of archived materials per month to each viewer.

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The all-important board of directors

The board of directors, the highest governing authority within a company, offers a fertile source of stories.

Often, however, journalists' scrutiny seems to come only when problems arise, such as when a company becomes embroiled in accounting scandals, or when its CEO is forced to resign.

But the board's unique power and its role in charting the company's activities make it worthy of continued attention.

The board's responsibilities broadly are to protect the company's interests and the shareholders' assets and ensure a return on their investment. All strategic decisions either originate with the board or must be approved by the board. More specifically, the board hires and fires the top executives; monitors company performance; approves financial statements; decides executive compensation and benefits; assesses and plans for potential risk and makes other major decisions, including whether to approve mergers or acquisitions.

Above all, the board sets the tone for the entire company, ensuring that it acts ethically, legally and responsibly.

For a list of board duties, see OECD Principles of Corporate Governance, "The Responsibilities of the Board," page 24: http://bit.ly/HArlwY

Types of boards and directors

To prevent the concentration of power and information in one or a few individuals, boards are advised to have a balance of executive and non-executive directors, some of whom are independent (see definition). Experts differ over the number of independent directors a board should have, but it is generally accepted that one-third to one-half of a board's directors should be independent.

Journalists covering boards need to understand the definitions used to describe directors and the boards themselves.

An *executive director* is also an executive of the company, such as a CEO or CFO. A *non-executive director* is not part of management and is valued for external perspectives and unique expertise.

"Non-executive" directors should meet in private regularly, without the presence of "executive" directors, according to governance experts.

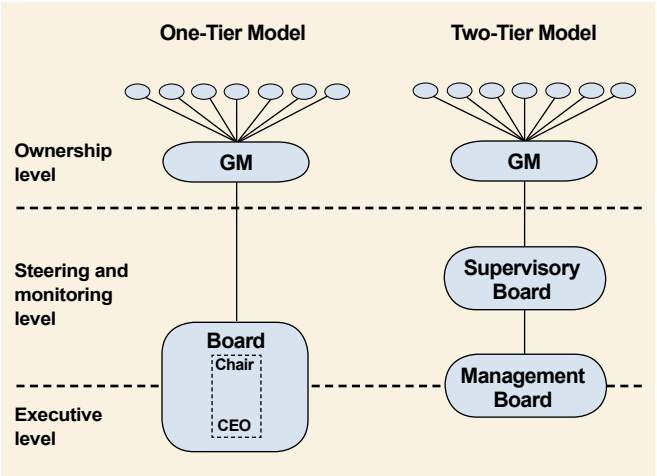
The independent director

Definitions of what "independent" means vary, but usually require the person to be free of financial, family and employment ties, or any other meaningful relation with the company, its directors and employees.

Other criteria include:

- Not a recent employee
- No recent material business relationship with the company
- No recent or current compensation from the company, other than director's fee, share options, performance-related pay or pension
- No close family ties with any of the company's advisers, directors or senior employees
- No cross-directorships or significant links with other directors through involvement in other companies or bodies
- Not a significant shareholder
- Not a long-term member

Source: "Corporate Governance Board Leadership Training Resources," Global Corporate Governance Forum, International Finance Corporation, World Bank Group.



In many countries, boards must have a specific proportion of independent directors.

Boards of directors can be either one-tier or two-tier.

- A *one-tier*, or unitary, board delegates day-to-day business to the CEO, management team, or executive committee, and is composed of both executive and non-executive members. This structure is most often found in countries with a common law tradition, such as the United States, the United Kingdom and Commonwealth countries.
- A *two-tier*, or dual, board divides supervisory and management duties into two separate bodies. The supervisory board oversees the management board, which handles day-to-day operations. This structure is common in countries with civil law traditions, primarily in Germany, but also in some companies in France and in many Eastern European countries.

Tip for journalists: In a two-tier system, do tensions exist between the two boards? These conflicts may lead to news stories exploring a company's ability to perform well.

Board, management have different roles

The board's role and responsibilities differ from those of management. To cover a company effectively, journalists must figure out how authority is shared in the management suite, and keep close track of changes among executives. The relationship between the board and management is equally important.

The management team starts with the CEO, who runs the day-to-day business of the company and sets its business strategy. It may also include a COO (chief operating officer), CFO (chief financial officer) and CIO (chief information officer), in addition to other top management roles, depending on the industry.

For definitions of each role within a corporation, see "The Basics of Corporate Structure," on Investopedia, a financial education website that commissions specialists in various financial fields to write explanatory articles on topics of interest to investors, and describes itself as an unbiased investing resource: http://bit.ly/HG44Qj

Power struggles and internal changes, such as the promotion, demotion or departure of an heir apparent, signify shifts in a company's hierarchy and future direction. Changes in the board, including director resignations and appointments, may signal important changes, too. That's why journalists should pay close attention to any such moves, which nearly always deserve a story. This means going well beyond the company press release, which may not clearly spell out the real reasons for personnel changes.

When boards have close connections to management, and few independent directors, corporate governance advocates see the potential for problems. In some of these cases, CEOs become dominant and the board may rubber-stamp management activities and proposals. A survey in 2011 by J.P. Morgan's Depositary Receipts (DR) business found this problem was acute in Latin America, where boards have a low level of independence.

"…Concentrated leadership can lead to increased risk exposure," wrote Nathaniel Parish Flannery, research analyst, in a posting about the J.P. Morgan survey for GovernanceMetrics International (GMI), which provides analysis and data on more than 20,000 companies worldwide to sovereign wealth funds, institutional investors and other clients.

Among companies cited were those in Mexico owned by billionaire Carlos Slim, the chairman and chief executive of telecommunications companies and other Mexican firms through his Grupo Carso SAB. His vast family empire controls more than 200 companies spanning industries including banking, telecoms, road-building and restaurants, according to newspaper accounts.

For more on Slim and his holdings, see:
http://tgr.ph/KEooiO

Potential conflicts

Journalists may come across the term "agency dilemma," used to describe the potential conflict between the shareholders' interests and those of the board. The board, persuaded by management, may be encouraged to seek short-term gains at the expense of the shareholders' longer-term interests in the company. Shareholders may be reluctant to assume risks, and that reluctance can be construed by management to stifle growth or make the company less competitive.

This is where directors play a key role, by thinking strategically and ensuring that the shareholders' best interests are represented by the board and that management is aligned with those interests. (*See chart below.*)

Examine the board's composition, effectiveness

The composition of boards of directors is one of the areas targeted by good governance organizations such as GMI.

The Corporate Library, which is part of GMI, developed a checklist to help investors evaluate the independence and potential effectiveness of a board. These include:

- *Size of the board.* There's no magic number, but the average board size is 9 to 10 members. Boards

Major Differences Between Direction and Management

	DIRECTORS	MANAGERS
Decision-Making	**Required to determine the future of the organization and protect its assets and reputation. They also need to consider how their decisions relate to stakeholders and the regulatory framework.**	**More concerned with implementing board decisions and policies.**
Duties, Responsibilities	**They have the ultimate responsibility for the company's long-term prosperity. Directors are normally required by law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. They can be personally liable if they are in breach of their duties or act improperly. They can be held responsible sometimes for the company's acts.**	**Not usually bound by directional responsibilities.**
Relationship with Shareholders	**Shareholders can remove them from office. In addition, a company's directors are accountable to the shareholders.**	**Appointed and dismissed usually by directors or management; they seldom have any legal requirement to be held to account.**
Leadership	**Provide the intrinsic leadership and direction at the top of the organization.**	**Day-to-day leadership is in the hands of the CEO; managers act on the director's behalf.**
Ethics, Values	**Play a key role in determing the company's values and ethical positions.**	**Must carry out the ethos, taking direction from the board.**
Company Administration	**Responsible for the company's administration.**	**Related duties associated with the company's administration can be delegated to management, but this does not relieve the directors of their ultimate responsibility.**
Statutory Provisions	**In many countries, there are numerous statutory provisions that can create offenses of strict liability under which directors may face penalties if the company fails to comply.**	**These statutory provisions do not usually affect managers.**

Source: Chris Pierce, "The Effective Director," London: Kogan Page, 2003.

that are too large may be unwieldy; boards that are too small may not be able to handle the workload.

- *Number of independent outsiders on the board.* A majority is considered ideal by many observers.
- *The presence of executive, audit, compensation and nominating committees.* Compensation and audit committees should be made up of independent directors. Some observers believe that the audit committee chairman should be a qualified or registered accounting practitioner — but again, there is no universal agreement on this point.
- *Limited directorships.* A board member generally should serve on no more than three boards, and the boards should not have conflicting interests.
- *Disclosure.* Companies must disclose transactions with executives, directors and other related parties that might constitute a conflict of interest.

Common convention holds that directors should own enough shares in the company so that they have a vested interest. On the other hand, corporate governance advocates caution against directors who have such large shareholdings and option grants that their judgment could be impaired by the desire to see the share price rise through accounting maneuvers for a short-term gain.

Directors should be paid adequately for their time on board business, and to compensate them for their expertise and experience.

"Independent" directors — outsiders with no connection to the company — should limit their shareholdings to less than 5 percent to maintain their independence, according to corporate governance experts. The percentage varies across countries; a new Companies Bill in India, expected to be enacted in 2012, proposes outside directors limit their share ownership to a 2-percent maximum.

Shareholders elect directors when they are proposed by the board, usually at annual meetings. In Asia, companies commonly have controlling shareholders who can control the nomination and election of board directors.

Term limits can vary by company and by country, but board terms generally last from one to three years.

For an overview of the responsibilities of boards and best practices, see: http://bit.ly/HDB765

Check board diversity

Board members should have skills and experience that match the company's needs. They also should have enough clout to challenge top management or the chairman, if necessary. These challenges, sometimes leaked by board members to journalists, make excellent stories that reveal a company's inner workings.

In recent years, governance advocates and shareholder activists have pressed to diversify boards, most notably by adding more women, and some countries have passed laws requiring it.

Advocates say that gender diversity leads to more variety in opinion, experiences, competencies and skills on boards. The advantages, they say, are balanced decisions, efficient oversight of financial management, enhanced accountability to shareholders and prudent risk management.

A 2012 report by GMI showed "incremental improvement" in female representation on boards from the previous year's survey. The survey of 4,300 companies in 43 countries found that women held 10.5 percent of the total number of board seats, up from 10 percent the previous year. The percent of boards with no women at all fell just

REPORTER'S NOTEBOOK

Studies and reports by auditing and consulting firms can provide ideas for stories.

Moulishree Srivastava of LiveMint, the online business publication, used the expertise of a partner at Grant Thornton India as a jumping-off point for a story on corporate governance challenges facing Indian family businesses.

These include:

- Attracting independent directors
- Opening up to private equity investment
- Thwarting fraud and managing risk

Read the story: http://bit.ly/HArSyV

STORY **TOOLBOX**

Story idea: Examine the structure of board committees for the companies that you cover.

- **Does the board have all the recommended committees?**
- **What kind of qualifications do committee members have?**
- **Do committee members have special expertise? (for example, members of the audit committee?)**
- **Are committee members independent? (see definition, this chapter.)**

For more on gender diversity on boards, see "Women on Boards: A Conversation with Male Directors": http://bit.ly/LEphFk

slightly below 40 percent. For the first time ever, GMI said its survey found that women held one in 10 board seats globally.

Dissecting board committees

Boards set up committees to delegate activities, provide detailed analysis on technical issues and make recommendations, which the full board typically must approve. The board retains full responsibility for the issues delegated. Committees allow directors to focus on particular areas, including those in which they may have special expertise. Committees report back to the board and also filter management proposals so they become strategic issues when presented to the board for decision.

Of the many committees a board may set up, the principal ones are:

- **Audit** — selects and oversees auditors' work
- **Compensation or Remuneration** — recommends how much the company should pay top management in cash, shares and other incentives
- **Nominating** — seeks, evaluates and recommends qualified candidates for election or appointment to the board of directors
- **Corporate Governance** — reviews policies and suggests reforms where needed. Boards may also establish an **Executive Committee**, which exercises the board's power between meetings, and a **Risk Committee**, to anticipate and plan for potential risks.

In the financial sector, it is increasingly common for banking laws and regulations to prescribe that the board establish certain committees and even spell out their composition and functions, particularly for risk management. Companies may also appoint permanent or ad hoc committees on such matters as ethics, crisis management, environmental policies, labor issues and technology.

In special circumstances, a committee may be formed to examine a potential conflict of interest or a possible acquisition, when an independent opinion of non-interested board members is necessary.

Certain committees, particularly audit, nomination, compensation and corporate governance, should comprise primarily independent directors, according to corporate governance best-practice guidelines.

Reviewing the composition of these committees may raise red flags. For example:

- Does the chairman tightly control all decision-making?
- Do conflicts of interest exist? (For example, do any Audit Committee directors have separate business ties with the auditor? With major shareholders?)
- Is board expertise adequate? (Does the Audit Committee include members with financial and accounting expertise?)

For other red flags on board committees, see: http://bit.ly/HGJADd

Learn to spot red flags

Once a company has imploded, the spotlight turns to the board and often illuminates what seem in retrospect to be obvious problems. The board at India's Satyam Computer Systems Ltd. was stacked with insiders who were either members of the controlling families, had close business or personal ties to the company's leaders, or who had little experience in the industry sector or financial expertise.

Problems may only come to light after a scandal has erupted, but journalists can expose these problems in

advance by diligent reporting. This means digging deeply into the background, experience, expertise and connections of directors, executives and controlling shareholders. Check the directors' board affiliations. Do any of them serve on common boards and have relationships built on those connections?

Such digging can reveal unexpected — and newsworthy — connections beneath the surface.

"While 'independent' directors are usually independent from the management of the company, many times these directors have significant connections either to other board members or to significant shareholders," says Dr. Nasser Saidi, chief economist and executive of Hawkamah Institute for Corporate Governance in Dubai.

When independent directors resign from a board, journalists and investors take note. Such resignations are not regular occurrences and may indicate deeper problems in the company. Resignations for "family" or "personal" reasons almost always deserve further digging by journalists.

Two independent directors of China-based Automated Touchstone Machine Ltd. (ATM) resigned in September of 2007, saying they could no longer vouch for the company's latest financial statements. The directors' resignations had even more impact because one was the chairman and the other a member of the audit committee at the Singapore Stock Exchange-listed company.

Such resignations became a regular occurrence at ATM before the exchange delisted the company in 2008.

A similar alarm was sounded by a director of China Aviation Oil, also a Singapore-listed company, when she resigned in 2008 after two years, saying she no longer could discharge her duties as an independent director because of the board's flouting of best practices. She also questioned the independence of certain other board members in a letter that she made public.

Chairman and CEO: separate or combined?

The question of whether the roles of chairman and chief executive officer should be separated is another issue that deserves attention.

According to proponents of the split roles, an independent board chairman can better protect shareholder interests by leading the board while the CEO runs the business, eliminating many conflicts of interest.

But others disagree, saying that the split roles are not the best choice for many companies. In their view, one boss is better because it avoids power struggles.

More large companies are separating the roles, and most of the new legislation and corporate governance codes endorse separation, but it's far from universally accepted practice.

The chairman/CEO combined role at Mexico's Grupo Televisa S.A. was the target of criticism by GMI, which frequently spotlights company practices that violate good governance principles, often before journalists notice and report on irregularities.

Among GMI's criticisms of Groupo Televisa:

- Televisa's chairman and CEO, Azcarraga Jean, who inherited the company from his father, did not appoint an independent chairman
- Only five members of the 20-member board appeared to be fully independent; several of them served on the boards of companies that do business with Televisa
- None of the non-executive members had significant executive experience in television
- The board's independence was "significantly affected" by the business relationships between individual directors and between directors and Televisa

GMI also criticized Televisa's lack of independent board committees and failure to appoint separate audit, com-

Among the questions that journalists might ask about the boards of companies they cover:

- How long have directors served on the board?
- What is the length of a term for a director?
- How many boards do directors serve on? What are their other interests in the company?
- Do any of them serve together on other boards? What kind of compensation do they receive?
- How many shares do directors have in the company?
- Have any directors sold shares recently? Is there a pattern?
- What is each director's attendance record?

pensation and corporate governance committees. The chairman of Televisa's audit and corporate practice committee was an 80-year-old director who had transactions with the company, and the chairman and two other board members were affiliated with Cablevision, which is owned by Televisa, GMI pointed out.

Be alert to compensation issues

Board independence can be critical in the area of compensation, a hot-button issue for the last two decades in developed markets.

Sensational compensation scandals have been far more prevalent in U.S. companies than in other parts of the world. But The Economist noted in 2008 that American-style bonuses and incentives for top executives have become commonplace in many European companies, and the trend has only become more pronounced since then.

Exchange-listed companies often disclose compensation in proxy statements, the ballot sent to shareholders before the company's annual meeting. Often this is the place where companies make disclosures about not only annual salaries for top executives, but also bonuses, benefits, share options and changes in retirement or separation agreements and pay.

Many stock exchanges in emerging markets do not require or enforce disclosure on executive compensation, so journalists may find these numbers hard to find. A study by the CFA Institute Centre for Financial Market Integrity, for example, found that compensation disclosure in Asian markets lagged behind international best practice and needed improvement to protect investors.

"The current practice in Asia deprives share owners of their right to know how much of the corporate funds they helped build are going to the individuals whom they have entrusted to run the business," the report says. "It also turns a blind eye on individual accountability."

In emerging markets, under-compensation, or even the lack of any compensation for non-executive directors, is a more pressing issue. Some companies pay non-executive board members a small stipend for each meeting, instead of the preferred annual retainer. Failing to compensate non-executive directors adequately may lead them to seek several board positions to boost their personal income, possibly diluting their interest in each company and their sense of responsibility.

Use reports to pinpoint important issues

Reports such as the CFA disclosure study can be gold mines for journalists who want to do regular stories on corporate governance. Research papers, surveys and blogs also pinpoint potential conflicts or poor practices in corporations, but often are ignored even by beat reporters who are covering the companies. Corporations are reviewed and rated on discipline, transparency, independence, accountability, responsibility and fairness.

In reporting on the CFA disclosure study, for example, journalists could examine disclosures by the top companies they cover and detail whether they comply with recommended best practices. Comparisons may also be made with other companies in the region or in the industry.

Annual surveys and scorecards by region are also useful to journalists searching for stories. The CLSA Asia Pacific Markets, an independent brokerage and investment group,

WHAT DO YOU KNOW?

Quick Quiz

1. **What is the difference between an executive director and a non-executive director?**
   - A. The executive director heads a board committee; the non-executive director does not
   - B. The executive director is also a member of management, while the non-executive director is not
   - C. There is no difference
2. **Which characteristic would disqualify a director from being independent?**
   - A. A member of the company's management
   - B. An expert in the company's industry
   - C. An executive at another company
3. **One of the following committees is most common for a board of directors. The others are optional. Which one is most common?**
   - A. Mergers and acquisitions
   - B. Audit committee
   - C. Ethics

Answers: 1. B, 2. A, 3. B

with the Asian Corporate Governance Association, publishes a yearly survey of corporate governance in Asia that covers 580 Asia-listed companies in 11 countries. ■

For a summary of the results of the 2010 survey, see: http://bit.ly/IESikf

SOURCES *Chapter 2*

Editor's note: The following sources were consulted in the preparation of Chapter 2. Most of the websites are accessible to any reader. Stories in certain publications, such as The Wall Street Journal and the Financial Times, require a subscription for access. The New York Times provides a limited number of archived materials per month to each viewer.

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All about shareholders

Many shareholders rely on journalists to track what companies are doing, whether boards are acting responsibly and whether their investments are being managed carefully.

In recent years, however, shareholders themselves have become more vocal and more actively involved in a range of issues. Regulators in various countries have given shareholders more clout by giving them the right to make nominations to the board.

The collapse of the U.S. subprime-lending markets in 2008 and the ensuing global financial crisis prompted sharper scrutiny of whether directors are fulfilling their responsibilities to shareholders. A flood of lawsuits and a deluge of media coverage followed.

Shareholder revolts are not always sparked by lone activists or institutional investors (insurance companies, pension funds and investment trusts that purchase large stakes in companies). Family-dominated companies may confront such revolts, too.

Macau casino mogul Stanley Ho had to cope with an internal family struggle over control of his empire, ultimately giving up most of his stake to resolve disputes among his heirs.

The Ho family saga played out in lawsuits among family members. Journalists scrambled to stay on top of the latest filings to make sure they weren't scooped by rivals. Lawsuits are often the way journalists discover shareholder actions, but having good sources among institutional investors, regulators, analysts, board members and company insiders is equally important.

To attract attention to their criticisms, shareholders often give information to the media. Sometimes a single shareholder can set off alarm bells and prompt reporters to examine what a company is doing.

That's what happened when a shareholder challenged the loan activities of PT Bumi Resources, the Indonesian coal company affiliated with London-listed Bumi plc. The shareholder, Nat Rothschild, a banking heir who owns 11 percent of Bumi, attacked PT Bumi Resources for giving loans to affiliated companies even while it was trying to refinance high-interest bearing debt.

He wrote a letter to company directors detailing his complaints, and provided a copy to a reporter at the Financial Times.

To see how the Financial Times handled this story about this lone shareholder railing against a big company, see: http://on.ft.com/IF2PvR

Knowing who shareholders are can help journalists learn what issues a company might confront. Reporters should examine a company's "beneficial owners." These owners enjoy the benefits of ownership, even though the shares are held in another name, such as a mutual fund or investment trust. In emerging markets and developing countries, securities markets are typically in the early stages and may lack registration procedures for share ownership, making it difficult to track down owners.

Some shareholders get shut out

Institutional investors took the lead in criticizing Rupert Murdoch's News Corp. after the telephone voicemail hacking scandal that focused attention on the news conglomerate's ethics and its board's stewardship in 2011.

The California Public Employees Retirement System (Calpers), the largest U.S. public pension fund, withheld its votes for the reelection of Rupert Murdoch and sons James and Lachlan to the News Corp. board of directors, motivating other institutional investors to take action. In early March 2012, Murdoch's son James resigned as

executive chairman of News International amid mounting shareholder pressures.

As many columnists pointed out during the weeks leading up to the company's annual meeting in October 2011, shareholders — even those with significant stakes — had little chance of achieving their goals. News Corp. has two classes of shares, with the Murdoch family's B shares holding 40 percent of the voting power. Some 60 percent of the shares have no voting power.

"These situations can leave the lower-class shareholders with a majority of the risk and no ability to push out managers who are either incompetent or evil," op-ed columnist Dan Gillmor wrote in The Guardian (U.K.).

Shareholders in emerging markets face similar problems, and protecting their interests has become a major concern.

Minority shareholders in Russia's Yukos Oil Company were left out in the cold when the government effectively dissolved the company in 2004. The owner and founder, Mikhail Khodorkovsky was sentenced to prison in Siberia. There is ongoing debate about whether the trials and sentencing were politically motivated.

Yukos investors, mostly foreign, have tried a variety of legal maneuvers in an attempt to recover up to $100 billion they invested in the company. Despite some minor victories in international courts, however, shareholders have won little relief so far.

Look for minority shareholder stories

Sometimes improper treatment of minority investors prompts regulatory action. That's what happened in a case involving Mexico's TV Azteca. Shareholders revolted when the company's chairman and CEO, Ricardo Salinas Pliego, came up with a scheme to finance a new telecom venture by having the publicly traded TV Azteca invest in his new enterprise, without notifying shareholders.

Minority shareholders filed a lawsuit. Several years later, the U.S. Securities and Exchange Commission (SEC) and Mexican authorities launched an investigation into the deal and the profits reaped by both Pliego and a colleague at the expense of the minority shareholders.

The SEC eventually charged Pliego with fraud. He settled the charges and paid a fine without admitting wrongdoing, but later he decided to delist his companies. Mexican regulators amended laws to force companies to provide more disclosure to minority investors.

In India, the government has been taking steps to prevent corporations from stepping on small shareholders. Under the proposed new Companies Bill, expected to be enacted in 2012, companies must offer an exit plan to shareholders who disagree with major company decisions, such as diversification or a major acquisition. The proposal, not yet translated into law, would do more than simply have dissenting shareholders sell their shares. Instead, a company would have to offer options to shareholders, possibly including buying back their shares.

Institutional investors often provide tip-offs to journalists about perceived problems at the companies where they have large stakes. Calpers is particularly active. The pension fund questioned the competence of BP plc's board in 2010 because of its handling of the Gulf of Mexico oil spill. Calpers, which held 60.6 million shares of BP, reportedly felt that the board had fallen down in overseeing the company's U.S. operations even before the spill.

In April 2011, Calpers was among BP shareholders voting against the company's reports and accounts at its annual meeting, and also voted against reelecting the director who had been the chairman of the BP board's safety committee.

The company's mishandling of the situation led in early March 2012 to a $7.8 billion settlement with more than 100,000 victims of the oil spill.

In emerging markets, where institutional shareholding is typically small, shareholders should be able to rely on journalists to dig into such stories and report on dissent within the company or among shareholders. Shareholder associations, becoming more common and more active in Asia and Africa, are a good source.

For example, Minority Shareholders' Watchdog Group (MSWG) in Malaysia has a website (http://www.mswg.org.my/web/) and now publishes a weekly electronic newsletter highlighting corporate governance issues and ongoing company transactions. The Securities Investors Association in Singapore (SIAS) (http://www.sias.org.sg/) performs a similar function and has had several successes in representing shareholder concerns to companies.

Shareholders of the privatized Karachi Electric Supply Company in Pakistan objected to the company's claims

Another good resource is the Code for Responsible Investing in South Africa: http://bit.ly/HDK2ol

How We Got the Story

Sometimes a tip can lead to a story about minority shareholders and their struggles. A good source network and knowledge of corporate governance principles are essential to landing the story.

That's what happened when officials at The Children's Investment Fund (TCI) alerted journalists about its plan to sue individual directors on the board of the recently privatized Coal India Limited. TCI is a minority investor in the company, which is 90 percent owned by the government.

In this edited account, journalist N Sundaresha Subramanian recounts how his newspaper, the Indian daily *Business Standard,* got the story:

As soon as TCI tipped us, I sensed the potential of the story — a classic David-Goliath tussle where an investor holding a meager 1 percent of the company takes on the big boy that controls 90 percent. I phoned Oscar Veldhuijzen, a partner in TCI.

Veldhuijzen said he had been writing to the management of Coal India ever since the fund invested in the company in the 2010 initial public offering. TCI decided to take action after the government issued a ministerial directive reversing a hike in coal prices, a move that would seriously affect the company's profitability.

Veldhuijzen obtained a copy of the coal price directive by using the Right to Information (RTI) Act, an Indian law that allows citizens to access information from the government. He provided us with a copy of the document, which showed that a senior government official had sent the directive to Coal India's chairman.

Because the document came from an interested party, I verified its authenticity by checking the official websites to ensure that the officials named actually occupied the posts.

We also needed the other side of the story, because the board of Coal India was being accused of failing to protect the interests of minority investors and failing in their fiduciary duties. My colleague in Delhi, who is in touch with ministry and company officials, contacted the company. Coal India refused to acknowledge the receipt of the letter from TCI. We were confident about the contents of the letter and had a first-person confirmation from the fund's officials, so we went ahead with the story.

All of this was accomplished in a couple of hours. We broke the story on our website that night, and it was published in the next day's edition.

Read the story: http://bit.ly/I9kRay

in its 2011 annual report that it had reduced post-tax losses from 2010 to 2011. The shareholders' association charges the lower losses were achieved by "excessive load shedding" — a term used to describe cuts in electricity when demand is high — and "exaggerated billing." Shareholders also criticized the company for decreasing generation of electricity and taking a larger government subsidy than when it was government-owned.

Read the story at: http://bit.ly/Hxaexa

Shareholder issues: Check companies' succession planning

Shareholder activists have wildly divergent opinions on certain subjects. The question of how much a CEO must disclose about his personal health set off a debate that spanned several years as Steve Jobs, CEO of Apple Inc., took successive medical leaves from the company, but revealed few details publicly.

It was The Wall Street Journal that revealed that Jobs had a liver transplant in 2009, months after the surgery occurred.

The SEC encourages companies to disclose succession plans, and journalists should ask about them when a top executive takes a sudden leave of absence. Aside from health, other reasons for abrupt CEO departures may be a rupture with the board or an offer from a rival company.

Succession plans for the future leadership of a company are particularly important for family-owned companies (see Chapter 4). The age of the founder should prompt sharp questions on future succession.

In 2011, perhaps prompted by the Jobs situation, a number of shareholder proposals requested that boards publicize their succession plans. Activists argued that if a chief executive's illness could affect the future prospects of the company, the board has a duty to disclose it.

Warren Buffett, CEO of Berkshire Hathaway, said information about top management's health problems should be divulged.

"If I have any serious illness, or something coming up of an important nature such as an operation or anything like that, I think the thing to do is just tell Berkshire shareholders

ers about it. I work for them," Buffett said in comments to Stanford University's Closer Look for an article on the topic.

Attend annual meetings to find stories

Some journalists believe it's a waste of time to attend annual meetings, because many meaningful issues are decided in advance of the events, and because in some cases, dominant shareholders determine the outcome in advance. But Melissa Preddy, a veteran business journalist, thinks the meetings are too valuable to pass up.

"The meetings are a good place to mingle with corporate executives and to beef up your contacts list with the names of active shareholders, directors, analysts, bloggers, community leaders with corporate ties and other stakeholders," Preddy wrote in a blog for the website of the Donald W. Reynolds National Center for Business Journalism.

Read her article at: http://bit.ly/HPaTwk

In preparation for the annual meeting, journalists should carefully study a company's proxy statement, the notice to investors, or ballot, usually issued about six weeks in advance of the meeting. (For a definition of "proxy," please see the Glossary.)

The proxy statement, in countries where stock exchanges or securities regulators require them, should include details about several matters. However, in many newly created stock exchanges, disclosure requirements are minimal and enforcement is weak. Still, it is worth checking proxy statements for:

- Details about compensation for executives and directors, including special benefits and loans
- Issues that will be presented for a vote at the annual meeting, including director elections
- Background and experience for director candidates should be provided, so that shareholders can make an informed decision
- Share option grants
- Information about existing directors' experience and other board affiliations

The information for any proposal to be presented at the annual meeting should be clear and complete. If not, journalists should ask why.

The proxy statement may also contain information about "related party transactions," where companies disclose deals made with their own executives and directors (see Chapter 5 for more on related party transactions).

For more information on how to find story ideas in a proxy, see Melissa Preddy's "Mine Proxy Statements for Executive Pay and Other Stories": http://bit.ly/J7XjAt

REPORTER'S NOTEBOOK

Alexey Navalny, an activist lawyer and blogger in Russia, bought a few shares in several of the country's largest companies and then began investigating their practices. He discovered that OAO Transneft, Russia's monopoly pipeline operator, had made $112 million in charitable contributions in 2009, almost eight times the amount of dividends paid to investors.

The charity contributions had been going on for several years, and reached $300 million in 2007 alone. Meanwhile, Transneft cut dividends to private shareholders by 75 percent from 2003 to 2009, even as its profits were rising.

The company refused Navalny's repeated requests for documents to show where the charitable contributions were funneled, leading him to observe, "No one [has] seen any traces of this charity.

"I spoke to many managers and employees of the biggest charity organizations, and they said they'd never seen this money." http://bloom.bg/HAykpC

Read a profile of Navalny by The New Yorker's Julia Ioffe: http://nyr.kr/HGk4Bz

> Business reporters and shareholders in companies from countries with high levels of corruption should pay close attention to the way large, Russian state-controlled companies are run and take a bolder stance against these pernicious practices."
>
> — *Alexey Navalny and Maxim Trudolyubov*
> **Nieman Reports, Spring 2011**

How to get the most out of the annual meeting

Journalists should not assume that they automatically will be admitted to annual meetings, though they usually are. Outsiders, including the press, have no legal right to attend, unless they own shares. Some reporters — if their organizations allow it — as well as shareholder activists have gotten around this challenge by buying just one or two shares in a company, simply to be admitted to the annual meeting.

Others simply work around the meeting, interviewing shareholders and others near the site or by telephone afterward.

"Sunshine is the best disinfectant, and companies that have nothing to hide welcome the press," Nell Minow, then editor of the watchdog Corporate Library, told The New York Times in 2005 after a company barred a Times reporter from its annual meeting.

Yahoo! Inc. drew the critics' wrath in 2001 when it refused to allow reporters to attend its annual meeting. Shareholders could listen to the meeting over the Internet. However, journalists complained that the ban inhibited their access to shareholders and prevented them from having a full sense of the meeting's tenor.

In recent years, more companies have held Internet-only annual meetings. Critics say this is just another way for companies to muffle dissent and insulate themselves from shareholders. Corporate officers, though, say the online meetings can attract more shareholder interest and give more people a chance to attend.

Another reason for attending annual meetings is to keep track of "gadfly" shareholders — activists who advocate for change within a company, often by showing up at annual meetings and pressuring management and the board on their favorite issues or causes.

Some journalists shy away from gadflies, seeing them as more likely to be pests than sources, but gadflies often shine a light on questionable practices and board failings.

Often, the first inkling of a major issue within a company comes from a gadfly shareholder proposal, so most business reporters cultivate sources among gadflies, while remaining wary.

Pay attention to shareholder rights issues

In the wake of widespread corporate scandals, the U.S. subprime mortgage meltdown and the global financial crisis, shareholders have embraced several initiatives designed to give them a stronger voice in companies and better protection for their investments. Shareholder propositions may provoke opposition and may generate story ideas.

In the United States, under SEC regulations, any shareholder who owns more than $2,000 in shares or 1 percent of a company is permitted to make a shareholder proposal. (The threshold may vary in other countries.)

Regulation and enforcement

In some markets, shareholders are pushing for tougher regulations on companies, particularly on disclosure and accountability, and more rigorous enforcement. Any such activism deserves the attention of journalists, who can also use the occasion to compare the rigor of their stock exchange's requirements with those in other countries.

Corporate social responsibility

Shareholders and stakeholders — such as customers, neighbors of company facilities and vendors — and governments often demand that companies act responsibly in protecting the environment, using natural resources sparingly and treating employees fairly.

STORY **TOOLBOX**

How easy is it for shareholders to participate in company meetings? Write a story on this in advance of a company meeting.

- **Are there obstacles to voting?**
- **Are there legal barriers, such as a requirement to notarize a proxy statement, or difficulty mailing in proxies?**
- **Are there artificial barriers, such as holding meetings in obscure, distant places at inconvenient times?**
- **Is sufficient time allowed on the agenda for meaningful interchange and questioning?**
- **How are notices of meetings delivered? In a legal advertisement published in an official bulletin that no one reads, sent by mail, by e-mail, or published on a popular publication?**
- **If the company holds annual meetings online, is there a way for shareholders to ask questions directly?**
- **Is the company's investor relations department responsive to questions about the company?**

— Source: Adapted from Backgrounder on Corporate Governance, Initiative for Policy Dialogue

Investors point to the business case for corporate social responsibility, saying that companies can earn good returns and outlast competitors. Pension funds, such as Norway's, are using guidelines and codes to evaluate whether companies in their portfolio or under consideration are good corporate citizens. More than 550 investment funds managing $18 trillion have signed U.N. Principles for Responsible Investment, a set of international guidelines, using their capital as clout.

Clashes between companies and community activists and investors are ideas for good news stories. For several years, Coca-Cola Co. in India has been under pressure to resolve water-scarcity problems farmers say are caused by Coke's bottling plants. For a story on the controversy, which also involves Intel Corp. in China, see: http://bloom.bg/HRwPGC

From 2011 onward, the Bear Creek Mining Corporation has faced as many as 25,000 protestors in Peru. Strikes erupted, and major highways were blocked with boulders to protest a new silver mine farmers feared would interfere with their livelihood. Women in the Niger Delta of Nigeria seized oil rigs to demand economic benefits from Chevron Nigeria Limited.

Governments may also apply pressure on companies that do business in their countries, especially when the business involves tapping into a country's natural resources. In Tanzania, for example, President Jakaya Kikwete urged extractive industries to buy goods and services locally.

"This will ensure a good relationship between the companies and the communities where they operate, otherwise hostilities between the two cannot be avoided," he said.

The way that boards address social responsibility sheds light on their corporate governance policies and practices and their investment outlook. Allowing chemicals to pollute surrounding communities may be a sign of deeper problems, from out-of-date manufacturing technologies to erosion in profits.

Questions for journalists to ask when covering issues involving corporate social responsibility include:

- Is the company listening to complaints and addressing them?
- Does anyone on the board or in senior management have conflicts of interest that allow them to benefit from the company using vendors who violate employment and environmental protection laws?
- Do stakeholders have valid criticisms?
- What will it take to fix the problems and what is the cost of the solutions?
- Is there any cover-up?

Watch to see whether crises arising from CSR conflicts lead to changes in leadership, harm the company's reputation and profits, create political problems for the government or press regulators to impose workplace, environmental and other regulations.

Institutional investors and nongovernmental organizations, such as environmental groups that have done independent evaluations of companies, are typically good sources for corporate social responsibility stories.

To better understand whether companies observe best practices, compare their track record with guidelines from

CLSA Asia Pacific Markets, which does an annual review of companies in Asia; the United Nations Global Compact; the Equator Principles of the International Finance Corporation; and the U.N. Principles for Responsible Investment developed by the world's largest pension funds.

These best practices include:

Tag-along rights
Protects minority shareholders if a majority shareholder sells a stake. Under this rule, if adopted by a company, minority shareholders have the right to join the transaction and sell their shares.

Separate chairman/CEO
See Chapter 2 for discussion of this issue.

Say on pay
Gives shareholders a nonbinding vote on executive compensation. In many countries, shareholders have been given this right as an advisory vote. Negative advisory votes are worth following, especially if they occur in successive years.

For a story on Australia's "two-strikes" compensation policy, see: http://bit.ly/HPb2Qv

Be alert for possibly shady deals

Regardless of whether shareholders take action, journalists should be alert to company actions that may not be in investors' best interests.

For example, in 2007, China National Offshore Oil Corporation Ltd. (CNOOC), which is listed in Hong Kong, sought to deposit funds for three years with another, state-owned company. Such a maneuver could have exposed shareholders to the risk of losses in an entity they didn't own, so more than 52 percent of independent shareholders voted against the scheme at an extraordinary meeting called to consider the move.

Alert journalists might have noticed that CNOOC had engineered a similar deal in 2004. Shareholders had approved that transaction, but they had received short notice for the shareholders' meeting, held during a holiday. A Bloomberg story at the time noted that "Chinese state-owned enterprises have been criticized for tapping profits from their publicly traded units…without shareholders' knowledge."

Hong Kong regulators later publicly censured CNOOC for violating disclosure rules on that 2004 transaction.

Beware of ethical pitfalls

Journalists who buy shares to gain insight into a company or to write a story should keep ethical considerations in mind. As long as the purchase is above board and transparent, and the amount purchased is minimal — one or two shares — it poses no problems.

But any subterfuge can be problematic. Wall Street Journal reporter Dennis Berman pretended to be his late grandmother in an attempt to buy shares in social networking website Facebook through SharesPost, a market for trading in nonpublic technology companies. Berman's goal was to test whether the system would detect his attempt to dodge the rules.

Berman defended his actions, saying that "applying a simple test to an entire way of doing business helped shed light on an important topic for investors and markets..."

However, he was severely criticized by rival reporters, including Reuters blogger Felix Salmon, for misrepresenting himself. Salmon called it "a cheap stunt," and questioned Berman's ethics. (See Chapter 7 for more on ethics for business reporters.) ■

WHAT DO YOU KNOW?

Quick Quiz

1. **Tag-along rights means:**
   A. Public citizens may attend a company's annual meetings
   B. Minority shareholders can join in if a majority shareholder sells a stake
   C. A method of voting on director nominations

2. **Succession planning is the responsibility of:**
   A. Shareholders
   B. Current managers
   C. The board of directors

3. **"Say on Pay" means:**
   A. Board chairman decides CEO compensation
   B. Compensation committee makes a decision
   C. Shareholders have an advisory voice in compensation issues

Answers: 1. B, 2. C, 3. C

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Inside family-owned and state-owned enterprises

State-owned enterprises (SOEs) and family-owned enterprises (FOEs), which dominate in most emerging markets' economies, can be difficult for journalists to penetrate.

Their structures may mimic those of publicly traded companies, with boards of directors, similar management structures, published financial reports and shareholders. Many SOEs and FOEs are listed on stock exchanges.

But these companies may operate with few checks and balances and limited disclosure, making it tough for journalists to unravel complex internal operations.

Increasingly, international watchdog and financial organizations are pressuring SOEs to operate more like public companies, especially when it comes to disclosure.

In the Middle East, for example, there is increasing interest in expanded transparency for FOEs and SOEs. Financial experts observe that SOEs and FOEs are critical to the economy, yet in some cases, they operate without adequate internal controls and proper oversight.

"Private companies and family-owned enterprises (FOEs) constitute the backbone of the corporate sector and account for a large fraction of employment. It is this sector that needs to grow if the region is to tackle the unemployment crisis and create jobs," says Dr. Nasser Saidi, chief economist and executive of the Hawkamah Institute for Corporate Governance in Dubai.

The organization of family firms can take various shapes:

- Wholly owned and managed by founders or their families
- Public or private companies in which the founder's family has a controlling stake and a leading role in executive management as well
- Companies in which families still have a significant influence

Understanding the family business

Worldwide, family companies create an estimated 70 percent to 90 percent of global GDP annually, according to the Family Firm Institute Inc.'s 2010 global data survey.

Stories about such businesses are often dramatic, featuring outsize personalities that are part of powerful, wealthy — and highly secretive — families. However, for journalists, family companies may pose difficulties because of their lack of transparency.

The terms "family-owned" and "family-controlled" are often used interchangeably. But in general, family members are the major shareholders in a *family-owned* business, while in a *family-managed* company, the family may be a minority shareholder, but controls the company through kinship ties, management roles and ownership of special classes of shares that wield voting power.

These companies have several benefits, including:

- Long-term view in decision-making
- Flexibility
- Desire to build a business for future generations
- Commitment of family management to company

On the other hand, family firms have common challenges. Issues often include a board of directors that is not sufficiently independent; strategic decisions made by family members and rubber-stamped by the board; blurred lines between responsibilities of directors and management; and increased tensions among factions as the controlling family grows and matures.

The key issues, however, are:

- **Non-professional management.** Family members often serve in management positions without proper qualifications.

- **Succession issues.** According to economist Dr. Joseph Fan's research of the Asian market: "In the five years after the company founder turns over the reins to the next generation, companies in the sample declined in value by an average of nearly 60 percent." Given the importance of family businesses for emerging markets, this issue poses major challenges for economic development.

Many family businesses appoint a family council to coordinate their interests and serve as the primary link between the family, the board and senior management. The council also suggests candidates for board membership and drafts policies on such items as family employment, compensation and shareholding.

Cultivating sources within the family council is key for journalists who want to stay on top of developments.

For more on family businesses and how they function, see "IFC Family Business Governance Handbook": http://bit.ly/JNjkqO

Be aware of family influence on the board

As always, journalists also need sources within the board, both those connected to the family and independent directors.

Board independence was an issue in the aftermath of the scandal at India's Satyam Computer Systems Ltd.

The Satyam fraud was revealed after the company initially agreed to pay $1.6 billion to acquire two companies run by the sons of Ramalinga Raju, Satyam's chairman and founder. Raju's family ran Satyam — his brother was CEO — with just an 8 percent shareholder stake.

But when the company attempted to acquire the two family-owned companies for a huge price, shareholders revolted and the shares took a pounding. The board reversed its decision on the acquisition.

Raju was forced to admit, in a public letter, that he had falsified the books over the years, and that $1.04 billion in cash and bank loans that the company listed as assets in the most recent quarter did not exist. Eventually, the company restated results for six years, from 2002 to 2008, to delineate the fraud.

How was Raju able to get away with the fraud for so many years, under the eyes of his board, regulators and auditors?

Should journalists have realized before the scandal broke that all was not right with the company? A BusinessWeek story counted the undetected red flags at Satyam:

- The board had six non-management directors, but four were academics and one was a former government cabinet secretary. Only one member had previously served as top executive of a technology company.
- The company had no financial expert on its audit committee.
- Although Satyam separated the positions of CEO and board chairman, both positions were occupied by brothers who also had a major interest in the company and were members of management.
- The board had no independent board leadership.

Questions to ask about family businesses:

- Does the family have its own governing body to interact with the board and management?
- Does the board have non-family directors? Are they truly independent, or somehow still connected with the family?
- How many generations of family have ruled the company? Are there generational tensions?
- Does the company have a way to monitor and address family conflicts of interest?
- Do unequal voting rights give family members a disproportionate role in shareholder decisions?

Examine structures of family companies

A "pyramidal" structure is common in family-dominated companies. Legally independent companies are controlled by the same family through a chain of ownership relations. The controlling shareholder — usually one who owns at least 20 percent of a company's voting rights — exercises control of one company through ownership of at least one other listed company.

Such companies can operate legally and ethically, but that kind of structure led U.S. investors to be wary when Chinese Internet company Renren Inc. floated an IPO on the New York Stock Exchange in 2011.

As the investor website Motley Fool pointed out, the company offering shares in Renren was a Cayman Islands-based holding company. The operating company for Renren in China was actually Beijing Qianxiang Tiancheng Technology Development, which would continue to be 99 percent owned by the Renren CEO's wife, a Chinese citizen.

A dual-class share structure, in which some shares have voting rights and others do not, also limited the influence of outside shareholders — a typical situation in family-dominated companies.

Despite those and other warning signs, Renren (RENN) raised $740 million at $14 per share.

The success of the IPO indicated that even red flags do not deter investors who think they have spotted a high-flying company. Soon, however, investor concern over accounting practices at Chinese firms took a toll on Renren, among other Chinese companies, and its share price dipped to $4.05 in early 2012.

Feuding families make good copy

Sometimes internal family feuds produce tabloid-style media coverage. In Mexico, for example, the Azcarraga family has controlled the largest television broadcaster, Grupo Televisa S.A., for three generations.

It wasn't until the widow of the company's former chairman was arrested and forced to relinquish her claim on a major stake in the company that observers began to look closely at how the company operated and at its board composition. It often takes a major event, such as the attempted power grab at Grupo Televisa, for family tensions to surface.

The Japan-based international beer company, Kirin Holdings Co., became embroiled in a family feud when it tried to acquire a controlling stake in a family-controlled Brazilian beer manufacturer, Schincariol Participacoes e Representacoes SA.

About 50 percent of the shares in the Brazilian company that Kirin sought to acquire are held by a company owned by the Shincariol CEO and his brother, who are descendants of the founder. However, the other 49 percent of Shincariol shares are owned by a company run by cousins in the same family.

The CEO and his brother were anxious to sell, but the cousins objected and went to court seeking an injunction. A story in The Asahi Shimbun, a Japanese national daily newspaper, detailed the family feud, which dated back to the 1950s, when the company's Italian immigrant founder divided ownership of the company between his two sons. Beer industry insiders said the family split was common knowledge, but Kirin apparently was not expecting the resistance it encountered.

As with all family business stories, writing authoritatively and accurately about the inner workings of such a company requires good sources within the company, whether insiders or outsiders, and within the family.

To see how reporters handled this story, see "Family Feud Upsetting Kirin's Expansion Plans in Brazil": http://bit.ly/IhYdK1

Mine lawsuits to uncover family secrets

Diligently reading and reporting on lawsuits helps journalists draw back the veil on family firms, because their disputes may end up in court where many of the proceedings and documents are public.

That was the case with a tabloid-worthy family feud that erupted in 2008 at Hong Kong's biggest property developer, Sun Hung Kai Properties Ltd. (SHKP), owned by one of the richest families in Hong Kong.

The drama was triggered when the company's chairman and CEO reportedly wanted to bring his lover onto the SHKP board. That prompted the CEO's two younger brothers to stage a boardroom coup, ousting him and replacing him with their 79-year-old mother. The raft of subsequent lawsuits included a defamation suit that the ousted CEO filed against his brothers, who had accused him in letters of suffering from manic depression and of being a "liar."

The consequences of these family struggles can be serious for shareholders.

"What happens when family loyalty turns to family feud? In the case of SHKP, the company's market value dropped $4.6 billion over a seven-day period," reporters wrote in Asia Times Online in a story at the time.

Read the story at: http://bit.ly/ILNhdw

(The younger brothers became co-chairmen of SHKP in 2011, replacing their mother. Their older brother remained a nonexecutive director.)

> "In Asia, where more than 70 percent of businesses are family-owned, many of the dominant firms are in transition now, as the founders are quite elderly. If family disputes lead to decisions that damage the businesses, this could cause broader damage to these economies..."
>
> *— Dr. Joseph Fan is a finance professor and co-director of the Institute of Economics and Finance at The Chinese University of Hong Kong.*

Watch for succession stories

Succession at family-dominated firms is a particularly tricky question. According to one global survey in 2011, 27 percent of such businesses expect to change hands in the next five years. But 47 percent had no succession plans in place.

The sudden illness or incapacitation of a family company CEO can be a major problem if there is no succession plan in place. One of the overriding issues is whether there is a suitable candidate from within the family, or whether an outsider will be considered.

Journalists should be alert to potential problems in SOEs, including:

- Does the board have any directors not appointed by the government, who have a degree of independence, or are all directors in some way connected with or formerly connected with the government?
- Does the board rubber-stamp government policies?
- Are company executives specialists in the industry sector, or are they political appointees?
- How is the government/company relationship structured?
- Is there political interference in management decisions — for example, if cutting jobs would be counter to the political goal of full employment, will government intervene?
- Does the government encourage domestic and foreign competition in the same sector as its SOEs or effectively stifle it?

The 2011 study, "Kin in the Game," by PricewaterhouseCoopers, found that 38 percent of family businesses surveyed had not nominated a caretaker management to step in if the CEO died suddenly before any of his children or other relatives were old enough to assume control.

A company also should welcome outsiders in management, according to many experts.

"Generally, the more professionals in management there are compared with family managers, the better run the company should be," Manesh Patel of Ernst & Young in Mumbai told the Financial Times.

State-owned enterprises

Journalists worldwide find themselves covering state-owned or state-controlled enterprises, with private businesses in the minority. This poses special challenges, not only because of the politics involved, but because such enterprises are usually secretive and unwilling to open their books or practices to the public. Yet they are often the backbone of a country's economy.

Underperforming SOEs undermine competition and thwart growth, says Dr. Saidi of Hawkamah Institute.

The solution: "We need to level the playing field with the private sector, reinforce the SOE's ownership function, try to delineate and avoid the mixing of political or social policy and business decisions, improve transparency, empower SOE boards and improve their accountability," he says.

Finding sources at state-owned enterprises

A journalist's best sources for SOEs are usually not publicly filed documents, but insiders, middle-management employees, foreign investors, competitors, whistleblowers

in government, opposition party leaders, vendors or even customers.

A hedge-fund manager tipped journalists to shady practices at Russia's state-owned oil company, Gazprom, in 2000. Bill Browder, manager of The Hermitage Fund, discovered by reading Russian securities registration data that Gazprom's managers were shifting corporate assets to entities controlled by friends and relatives.

Stories in the Financial Times, BusinessWeek and The New York Times eventually led to reforms within Gazprom, including the replacement of the CEO. Browder frankly admitted that he had a financial incentive for tipping off reporters. His investment in the company grew from $50 million to $1.5 billion as the irregularities were revealed.

The hedge-fund manager had the time, expertise and resources to unravel Gazprom's complex internal structure and figure out what was going on. He then passed that information along to select reporters, betting correctly that media attention would put pressure on the company to clean up its practices.

The unfolding of the Gazprom story was examined at a conference sponsored by the Weiss Center for International Financial Research at the University of Pennsylvania Wharton School. Read about it at: http://bit.ly/IhYdK1

Watch government pull strings

Politics play a major role in the operations of SOEs.

To increase profits and cut costs, for example, a company's best strategy might be to eliminate jobs and raise prices. However, its owner, the state, might oppose these and any other actions that would raise unemployment or fuel inflation. Regulators may look the other way instead of cracking down on workplace-safety violations.

Even when the government is not the majority shareholder in a company, or no longer holds a direct ownership stake, it can meddle in corporate affairs and affect operations.

Brazil's Vale S.A., the world's biggest miner of iron ore, was privatized in 1997. But the government, which wielded power through public sector pension fund investments in the company, continued to dominate. In 2011, government pressure forced out the company's CEO, Roger Agnelli, because of displeasure with his strategy of stepping up exports to other countries.

Politicians had criticized Agnelli for several years, charging him with failing to create and keep jobs and cutting investments after the 2008 financial crisis. He ignored their pleas to build steel plants in Brazil and to cut back on iron ore exports to foreign steel producers, such as China. Agnelli eventually paid the price for taking the company in a direction that did not have government support.

Similarly, Russian officials succeeding in getting rid of CEO Bob Dudley of TNK-BP Ltd., a joint venture. London-based BP plc's 50-percent stake proved no match for the power of the Russian tycoons who engineered legal and regulatory pressure on the company in 2008.

Many Western managers, including Dudley, left TNK-BP complaining that the Russian shareholders — aided by the government — were behind legal and regulatory pressures on the venture. Ultimately, in a compromise reached in 2009, the board was whittled down from 13 members to six, with BP losing significant control, and a new CEO was appointed.

TNK-BP touted the addition of independent directors to the newly reconstituted board, including former German Chancellor Gerhard Schroeder. But in early 2012, Schroeder and another independent director reportedly resigned when TNK-BP took steps to sue BP for attempting to make a side deal with Rosneft, another major Russian state energy company.

The Vale and TNK-BP experiences illustrate why journalists should pay close attention to how the state can influence companies' operations, even interfering with management and ousting CEOs who do not follow directions.

Politics often play a role in companies that are ostensibly free of government control. That's often the case with giant telecommunications companies, which usually are heavily regulated and subject to political persuasion.

In South Africa, union critics alleged that politics played a role in the telecom firm Telkom's decision to sell a portion of its interest in Vodacom, the largest operator in Africa, to British operator Vodafone, and that the tender process was corrupt.

The Communications Workers Union (CWU) and the South African Communications Union charged that various Telkom moves — which included outsourcing some of its operations — were linked to political upheaval, with company executives seeking to "secure their futures" before new political leadership could impose any changes,

according to reporter Lesley Stones' article in Johannesburg's Business Day.

Labor organizations can be fruitful sources for journalists when political interference threatens jobs, though their accusations must be weighed carefully for accuracy and fairness.

On the bright side

That doesn't mean that all state-controlled companies are mismanaged or manipulated. On the contrary, many are major revenue and job producers. As The Economist noted in a special report on emerging-market multinationals, the world's ten biggest oil-and-gas corporations, measured by reserves, are all state-owned, and state-backed companies account for 80 percent of the value of China's stock market and 62 percent of Russia's.

Read the essay at: http://econ.st/HGWktw

Business Times of India acknowledged the problems with SOEs, but chose to focus on some that performed extremely well, such as Indian Oil, Steel Authority of India Ltd. and State Bank of India, among others.

The Business Times focused on Kolkata-based Hindustan Copper, which once had illustrated many of the problems that typically plague SOEs: too many employees, poor economies of scale, inability to adjust to a declining market. But a voluntary retirement policy helped cut the workforce from 26,000 to 6,000, and the company streamlined its production methods and paid down its debt, becoming one of the Business Times' success stories.

Read the story at: http://bit.ly/lISYLF

STORY **TOOLBOX**

Examine the background, expertise and connections — business and personal — of directors and managers of several SOEs in your country.

In many cases, such information is not made public by the company or included in its disclosures. That means extra digging by journalists to find biographical information on key officials, to determine whether they have the expertise the business needs and how connected they are to the government or other key players.

Transparency a major issue at SOEs

Typically, SOEs lag behind listed companies in disclosing information about operations, finances and management structure.

The basic standards for disclosure should be the same as those for listed companies. Often, though, even when SOEs are listed on the country or regional exchange, such requirements are not enforced. Does the company file annual and periodic financial statements? Are these audited? By whom? Are shareholders adequately informed and involved in annual meetings?

For an in-depth discussion of transparency and disclosure standards for SOEs, see "Guidelines on Corporate Governance of State-Owned Enterprises," from Organization for Economic Coorperation and Development (OECD), page 16: http://bit.ly/IhYVXR

The Russian government-controlled oil company Transneft illustrated the difficulties shareholders can face when a state-controlled company refuses to disclose its operations. It took a shareholder activist, Alexey Navalny, to discover that even though the company cut dividends to shareholders by 75 percent from 2003 to 2009, it supposedly gave $112 million in charitable donations in 2009. (See Reporter's Notebook, Chapter 3, for more on how Navalny pursued the company on behalf of shareholders.)

Navalny, despite lawsuits he filed, has so far been unable to force the company to provide a list of recipients for its donations. Transneft calls the information "confidential," even though the charitable contributions came from the company's profits.

The consequences of poor governance at SOEs can have far-reaching implications. Typically, they significantly underperform, thus depriving the public of benefits. Ultimately, journalists should ask whether the company has a sustainable business or must rely heavily on government subsidies.

To check on whether an SOE is complying with minimal disclosure, journalists should ask these questions:

- Is there a clear mandate with specific objectives set for the company, including company priorities, available on the company website?
- Are special benefits, such as low-cost loans, provided to the company detailed publicly?

REPORTER'S NOTEBOOK

The Financial Times' Kevin Brown examined the difficulties of succession planning in family companies, particularly those in Asia. His story cites a number of examples, ranging from Indonesia's Bakrie family, to India's Tata, to the internal struggles of Stanley Ho's Macao gambling empire. This kind of story is ideal for countries where family companies dominate.

Read the story: http://on.ft.com/HxfCjX

- Are there special obligations (such as free travel for government officials on a state airline) that the company is obliged to provide? Are these disclosed? Are these obligations specifically identified?
- Is the process for nominating and choosing board members disclosed?
- Is the background of the directors and management available to the public? Do they have expertise related to the industry?

Watch how shareholders are treated

Just as in other listed companies, SOEs should treat all shareholders equally. However, this is often not the case, and many stories in recent years about SOEs involve violation of minority shareholders' rights.

One of the methods SOEs used to deprive minority shareholders of their assets, particularly in Russia and Eastern Europe during the early days of privatization, was called "tunneling." This involves the transfer of resources from the company to individuals or entities they own, and can include anything from selling assets at bargain-basement prices to loan guarantees at far below market rates.

Tunneling can also be accomplished when controlling shareholders increase their own shares of a company by diluting the value of minority shares, or even simply outvoting minority shareholders.

Some post-Soviet privatizations are still making news: The Swiss federal prosecutor's office recently charged six Czechs and a Belgian with money laundering and other charges for allegedly syphoning off company cash to allow themselves to take control of a Czech mining company in 1999.

A recent academic research paper raised the possibility that similar kinds of tunneling activities are taking place today in Chinese companies. In this case, researchers speculate that private controlling shareholders and owners, not the state, are behind the schemes. ■

WHAT DO YOU KNOW?

Quick Quiz

1. **What is tunneling?**
   - A. Separating management roles by function
   - B. Directing profits to company activities rather than dividends
   - C. Transferring the company's assets to deprive shareholders of value
2. **A "pyramidal" structure in a family-dominated company means:**
   - A. The founder is board chairman, other relatives are in top management
   - B. The family dominates the board of directors
   - C. A group of legally independent companies are controlled by the same family
3. **A dual-class share structure, common in family businesses:**
   - A. Gives one class of shares more power, specifically voting rights
   - B. Allows some shareholders to sell their shares at a premium
   - C. Refers only to dividends

Answers: 1. C, 2. C, 3. A

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CHAPTER 5

Toeing the line: regulations and disclosure

Some of the most explosive corporate governance scandals of the last two decades have revolved around deliberate fraud.

Being able to spot irregularities in financial and nonfinancial disclosures made in regulatory filings is a must for investigative business reporters. That often means reading the fine print and doggedly attempting to understand the financial information and technical language.

Financial enforcement and securities regulation agencies and stock exchanges should discover fraud and launch an investigation. However, that doesn't always happen. Enron Corp. sneaked by the U.S. Securities and Exchange Commission (SEC) for many quarters before investigators belatedly launched a probe.

Most of the major corporate scams worldwide in the past two decades took place under the very noses of regulators, auditors, banks and other financial institutions, to say nothing of directors and shareholders.

How do they get away with it?

In one of the largest frauds in history — though it certainly has competition from subsequent events — managers of Korea's Daewoo Group used accounting maneuvers in the late 1990s to commit a $15.3 billion fraud, which included inflating the company's equity by $32 billion. The scheme involved dozens of company officials, including several who went to prison and paid large fines.

The company's founder and chairman was accused of a host of criminal charges, sentenced to 10 years in prison and directed to forfeit $22 billion, much of which he had sent out of the country.

As with most of the scandals covered in this Guide, journalists wrote about the events afterward, not in advance. The goal of media is to get out in front of a story like this by reporting on irregularities or suspicious claims before they erupt in a scandal. Is that possible?

"Anyone carefully studying Daewoo's books could detect misconduct of that magnitude," Lee Dong Gull, a former Korean presidential economic adviser, told BusinessWeek in 2001. (For tips on how to recognize certain accounting gimmicks, see charts on spotting "shenanigans," Chapter 6.)

Lee added that those held responsible for such frauds should include "the accounting firms and regulatory officials who overlooked the fraud."

Stock exchanges and regulatory agencies are supposed to discover such manipulations, essentially by rigorously enforcing disclosure and filing requirements. Often, though, it does not work that way, for several reasons:

- Many exchanges and enforcement agencies in emerging markets have lax rules, limited resources or are not skilled in handling complex laws and regulations
- Enforcement is weak or non-existent
- Managers and financial experts within companies become expert at hiding their dealings
- Media are not diligent about reading and reporting on financial and other disclosures, or writing about companies that fail to file on time or omit critical information

Securities regulators are being pushed to toughen enforcement, and the pressure has had some impact. In 2011, Vietnam's market regulator, the State Securities Commission (SSC), published the names of 14 listed companies that violated disclosure requirements, primarily by late filing of financial statements.

The SSC's tougher stance was prompted by the revelation that Vien Dong Pharmaceutical (DVD), which was listed on the Ho Chi Minh Stock Exchange, concealed from shareholders and regulators that it was forced into involuntary bankruptcy by heavy debt. But critics argue that warnings, fines and trading suspensions are not strong enough to

reform the market, and say that only by delisting offending companies can regulators improve transparency practices.

Perhaps the most dramatic example of a success story is Brazil's Novo Mercado, a special market for companies that voluntarily observe good governance guidelines. The market, created in 2000 by Brazil's stock exchange, Bovespa, is credited with raising the standards of corporate governance in Brazil and setting an example for exchanges in other emerging markets.

Before Novo Mercado was launched, both domestic and foreign investors were wary of Brazilian companies, and IPOs were rare. Although Novo Mercado got off to a slow start, it now has more than 100 listed companies and hosts frequent IPOs.

An executive of Brazil's investor relations association even credited the governance improvements inspired by Novo Mercado with helping the country get through the worldwide financial crisis in 2008-2009.

Read about the impact of Novo Mercado at: http://bit.ly/lFrv7o

Read more about the origins of Novo Mercado at: http://bit.ly/HGhfRh

Where to look, what to look for

One of the key areas to examine is related party transactions, which involve a business deal or arrangement between any two parties who are joined by a special relationship. This could be a deal between a major shareholder and the corporation, or between the corporation and a relative of senior management or a director.

The basic documents required by many regulators and exchanges worldwide are similar to those required by the U.S. Securities and Exchange Commission (SEC).

Unaudited periodic (often quarterly) financial statements (Form 10-Q). Look for:

- Abrupt shifts in revenue, profits, expenses, cash flow, assets and liabilities. What accounts for the change?
- Share purchases — Has the company increased or decreased its share buying? Why?
- Current litigation — Are there any new lawsuits, or cash reserved for a possible loss? If so, what is the nature of the anticipated loss?
- Spending plans — Are major purchases ahead?
- M&A update — What is the impact of a recent merger or acquisition? Is there a sound explanation for the change in revenues and profits?

Audited annual financial statements (Form 10-K). All items listed above will also appear in the 10-K.

Current information, including major events that shareholders should know about (Form 8-K), including:

- Departure or illness of a key executive or board member
- Auditing firm changes
- Major acquisition or divestiture
- Change in fiscal year
- Delisting of company shares
- Regulatory actions
- Bankruptcy or receivership

Annual proxy statement (Schedule 14A), which discloses questions to be put to a shareholder vote, including election of directors, along with information on executive compensation

Registration statements, including prospectuses for share offerings (Form S-1, or Form F-1, for foreign private companies going public)

Insider holdings and transactions (Forms 3, 4, and 5), including initial holdings of stock by the company's executives, changes in ownership and purchases or sales

For a thorough explanation of each filing requirement and how to find filings for companies in the SEC's free EDGAR (Electronic Data Gathering, Analysis and Retrieval) database, see: http://1.usa.gov/lvpgae

(For a more detailed discussion of how to read and interpret numbers in periodic and annual financial filings, see Chapter 6. For an explanation of proxy statements, see Chapter 3.)

Related-party transactions might not be abusive, but companies can use these transactions to inflate sales or lower costs and show higher profits on their financial statements.

Listed corporations are required to disclose such relationships in the annual report, and all companies should disclose related party relationships to shareholders.

Related party transactions might not be abusive, but companies can use these transactions to inflate sales or lower costs and show higher profits on their financial statements. Such transactions can also be used to transfer funds or assets out of a publicly owned business to insiders who control or own privately held companies (see "tunneling" in Chapter 4).

Red flags for journalists include ties of board members to other companies that are vendors; family members in key positions of the companies doing business with one another; and disproportionately high costs for supplies of goods and services.

Boardroom infighting can also be a tipoff to suspicious related party transactions. That was the case at Kenya's Cooper Motor Corporation (CMC), where the company's managing director alleged that two directors had formed a syndicate to siphon off funds to offshore accounts. The chairman of the Capital Markets Authority in Kenya admitted that the regulator originally heard about the charges from the press, and said the board did not fully disclose its financial position in regulatory filings.

CMC's shares were suspended from trading while the regulator investigated the various internal allegations, which included allegations that a former board member had overcharged the company for its services. Such conflicts of interest led to the boardroom wars, according to an analysis of the CMC situation and its implications for investor confidence in The Daily Nation, Nairobi.

Read the story at: http://bit.ly/HDSWOd

CEO uncovers fraud at Olympus

Olympus Corp., the Japanese camera and endoscope manufacturer, delayed its fiscal second-quarter earnings release in November of 2011, after abruptly removing its British chief executive — two red flags in quick succession. The CEO had raised questions about past acquisitions that involved multimillion-dollar payouts for companies that seemed to have negligible value, and he made those questions public.

The deals, which had occurred over several years, were used to hide investment losses dating back two decades. The scheme and cover-up reportedly involved top company officials, including the chairman, president and the internal auditor.

Deeper probing into the companies that Olympus acquired might have raised suspicions much earlier. A subsequent investigation by a panel appointed by the board found that fees to buy the companies in some cases amounted to more than a third of the value of the acquisitions themselves. These maneuvers went undiscovered for years, though.

After the board chairman resigned and the special panel was appointed to investigate the acquisitions, the Tokyo Stock Exchange (TSE) pressed Olympus for more disclosure and criticized its slow reaction to investor concerns that led to a sharp decline in share value. The TSE threatened to delist Olympus.

Such actions, though, are not necessarily good for shareholders. The Asian Corporate Governance Association publicly asked the TSE not to delist Olympus, saying "delisting is generally not a favorable penalty for securities malfeasance since it punishes shareholders as much as the managers responsible."

ACGA also noted that, on exchanges in most developed countries, a company such as Olympus would not be

STORY **TOOLBOX**

Story idea: Track share trades by prominent investors to uncover stories about which shares are hot and which might be declining.

Example: Any shares traded by a major investor, such as Warren Buffett's Berkshire Hathaway, attracts media attention. Even though Buffett had long shunned investment in technology shares, journalists noted in fall of 2011 that he had bought stakes in IBM and Intel.
http://aol.it/HEaj6c

delisted, because "it remains a going concern with a reasonable business."

Look for suspicious claims

Journalists can dig beneath the surface and go beyond paper filings to uncover irregularities.

Reporters from Canada's The Globe and Mail and research firm Muddy Waters alleged in the fall of 2011 that Chinese company Sino-Forest Corp. — Canada's largest publicly traded timber company — overstated the size and value of its timber holdings in China's Yunnan Province. (For a look at how reporters verified the discrepancies, see Reporter's Notebook, this chapter.)

Sino-Forest denied the allegations, but after doubts were raised, the Ontario Securities Commission accused the company of misrepresenting its revenues and exaggerating its timber holdings. The OSC temporarily halted trading in the company's shares and also asked that the chairman/CEO and several company directors resign. The Royal Canadian Mounted Police also got involved, launching a criminal probe into fraud allegations.

For an opinion column on the conflict that sometimes occurs between auditors' opinions and investment research firms, see: http://nyti.ms/HAEPZC

In most countries, failure to disclose information that has a "material" or significant effect on the company's value incurs penalties. In addition, such disclosures must be timely. If they're not, it's a red flag for journalists and regulators.

How can journalists find stories by monitoring company disclosures? Here are some tips:

1. Become familiar with regulatory requirements

The role of stock exchanges and security regulators in making sure companies operate legally and in the best interests of shareholders is especially important in emerging markets, where regulation and enforcement tend to be weak. However, such requirements vary widely, and so does enforcement.

Journalists should become familiar with listing and delisting regulations for the exchanges they cover, and then monitor enforcement diligently. This includes paying attention even to the basics, such as whether companies file financial statements on time. Listing and delisting regulations are published by the exchanges themselves or by the securities regulatory agency, often on their websites.

Filing delays often indicate that something is amiss. Transmile Group, a Malaysian freight operator, delayed filing its annual report in 2007 for several months. When it finally filed, the company showed a new loss of $36.05 million. The late filings followed the disclosure that the company had overstated its revenues in 2004 and 2005.

As a result of this scandal, two independent directors of Transmile's audit committee were later sentenced to prison and fined for making misleading statements in the company's quarterly report to Bursa Malaysia.

Even if there are no losses or false statements connected with filing delays, such delays can indicate that the company's financial functions do not have sufficient resources or are incompetent.

In contrast, improvements in governance and compliance with regulations can have a positive impact on a company's reputation. In 2012, ratings agencies Standard & Poor's (S&P) and Renaissance Capital (RenCap) noted the improvement of the Nigerian banking industry, especially in the areas of risk management and governance.

"Nigeria now has fewer, but larger, banks with better corporate governance and regulatory oversight," S&P said in a statement.

Journalists who are knowledgeable about the regulations in the sectors they cover, whether banking, commodities, manufacturing or other areas, are in good position to recognize an important news development in press releases issued by regulators or, as in this case, reports from rating agencies, reported in This Day, Lagos.

Read the story at: http://bit.ly/Hxh6Lg

REPORTER'S NOTEBOOK

Sometimes probing into the truthfulness of a company's disclosures requires a lot more than simply poring over paper filings and examining the numbers.

In fall of 2011, reporters at Canada's The Globe and Mail traveled to China and spent two weeks on the ground there, investigating Sino-Forest Corp., the timber giant that is listed on the Canadian exchange.

Researchers at Muddy Waters LLC initially had raised alarms about the company, alleging that the company was perpetrating a fraud by inflating the value of its timber holdings.

Reporters spent two weeks in Yunnan Province, conducting interviews with local government officials, forestry experts, local business operators and brokers to break the story that essentially backed up Muddy Waters' claims. The company continues to deny the allegations.

Read The Globe and Mail story: http://bit.ly/HAF1rW

What can regulators do? Depending on the country's legislative, legal and regulatory framework, they can:

- Withdraw a company's license to operate
- Halt trading in its shares
- Censure a company by so-called "name and shame" statements
- Levy financial penalties
- Seek court injunctions
- Apply to the court to freeze company assets
- Censure, fine, prosecute and seek court injunctions against directors

2. Pay attention to share trading by insiders

Some lay people associate the term "insider trading" with illegal activity, but company executives and board members may buy and sell shares in the company as long as they observe the disclosure regulations and strictly observe the company's own internal policies on trading.

It is illegal for any insider to use non-public information — special knowledge — for any share-trading purpose, including tipping off friends or relatives to news that could cause shares to rise or fall sharply, so called "material news."

On most exchanges, corporate insiders — including management and directors, along with any individual who has a significant stake in a company — must report their holdings and transactions in the company's shares.

Insiders are not only the company's top management and directors, but can also include brokers, friends, family, stakeholders and consultants who may have access to inside information that is not public.

Such disclosure requirements for share trading by insiders vary widely by exchange, and may be minimal in emerging markets. But where such disclosures are required, journalists should keep track of any trades, changes in ownership and trading patterns. They are worth a regular monthly story on trades by directors and managers at top companies.

The biggest insider trading criminal conviction to date involved Raj Rajaratnam, an investor who once ran Galleon Group, one of the world's largest hedge funds. He received the stiffest prison sentence so far — 11 years — and a $10 million fine in 2011 for trading on information provided by company insiders to rack up more than $50 million in profits. The SEC later assessed a $92.8 million penalty on Rajaratnam, the largest ever imposed for insider trading.

Even when not criminal, insiders' decisions to buy or sell shares often send signals to shareholders and would-be investors, making the information newsworthy.

The media reported on Nov. 3, 2011, that Sergey Brin, co-founder and a director of Google Inc., sold 83,334 shares of Google Inc., or almost $48.5 million, on Nov. 1. This was part of a planned strategy by Brin and co-founder Larry Page to sell off some of their holdings over a period of time and give up majority control of the company. For the insider transaction page where this was reported, see: http://yhoo.it/L0IC8P

For example, a prominent Thai family sold its remaining 49.6 percent stake in a leading Thai telecommunications company, Shin Corp., just three days after a new telecommunications act took effect in 2006. The families netted about $1.88 billion from the deal. Certainly other investors and shareholders would have found such information worth knowing.

For more on how to track insider trading, see: http://bit.ly/ISulrE

3. Be alert for share manipulation

Share manipulation can be difficult for journalists to detect unless they are tipped off by regulators, brokers or analysts who notice unusual changes in share purchases and price fluctuations.

There have been occasions when journalists were accused by companies of influencing share prices by printing negative news, but as long as the news is accurate and factual, journalists bear no responsibility for the effect of their reporting on share prices.

A case of share manipulation led to a criminal investigation in February 2012 in South Korea, where a former senior government official was accused of hyping the operations of a South Korean developer, CNK International, in a diamond mining project in Cameroon.

The former vice foreign minister, who was serving as an adviser to the mining company, issued a press release claiming that that CNK had secured a project to mine about 420 million carets of diamonds in Cameroon.

The foreign ministry issued its own press release, which led to an immediate and sharp hike in the company's share price. The former minister, Cho Jung-pyo, allegedly made more than $1 billion from the scheme. Prosecutors said other government officials could be implicated as well.

4. Examine auditors' report

In almost all the corporate scandals mentioned in this Guide, auditing firms have been castigated for failing to spot fraud, and some have even been criminally charged.

The principal role of an auditor is to determine if financial reports were prepared in accordance with accounting rules and principles. Auditors note that they relied solely on the information provided by the company's management. Their opinions are limited to stating whether the company has complied with accounting rules and principles.

In the United States, Arthur Andersen, which signed off on all Enron transactions and received large fees from the company, was ultimately destroyed by such failures and a criminal indictment from the U.S. Justice Department, even though it was never convicted of wrongdoing in its audits. In Italy, the reputations of bankrupt Parmalat SpA's audi-

Journalists writing about annual reports and financial statements need to understand the various types of audit opinions.

In the audit report, the independent auditing firm expresses its unbiased opinion on the company's financial statements. Audit opinion provides "reasonable assurance" that statements are free of "material" misstatements, but are not a guarantee.

Unqualified Opinion — No reservations about the financial statements.

Qualified Opinion — The auditor takes exception to certain current-period accounting applications or cannot establish the potential outcome of a material uncertainty.

Disclaimer of Opinion — Auditor does not have enough information to obtain sufficient evidence, and cannot provide an opinion on the financial statements.

Adverse Opinion — Auditor asserts that financial statements do not present the financial position, results of operations and changes in financial position in conformity with generally accepted accounting principles.

Journalists should be alert for another paragraph that might be part of an auditor's report, called "emphasis of matter." These are used by the auditor to draw the reader's attention to certain disclosures in the directors' report, and are becoming more common, according to some experts. Emphasis of matter statements are typically issued when there's uncertainty about the company's ability to survive as a "going concern." "Going concern" means that there is a reasonable expectation that the company will continue in business for the next period and that there are no significant doubts that the company can pay its debts for that period.

tors, Grant Thornton and Deloitte Touche Tohmatsu, were battered by their failure to detect fraud in the dairy company's books. They eventually agreed to pay a $15 million settlement to shareholders.

In fact, all of the Big Four accounting firms have featured in criminal cases involving clients at one time or other. Two PricewaterhouseCoopers partners were criminally charged in connection with the Satyam Computer Systems Ltd. fraud in India. KPMG was charged by the SEC with permitting Xerox Corp. to manipulate accounts. KPMG settled the complaint in 2005 without admitting wrongdoing.

Questions reporters should ask about a company's auditors and their audits include:

- Is the external auditor qualified, credible, independent and free of regulatory or legal problems?
- What are the limitations of the auditors' opinion?
- What process was used to verify and audit the financial statements?
- What does the audit report say about the company's financial statements?
- What kind of business relationship does the auditing firm have with the company, aside from its audit services? Any conflicts of interest?
- Is the audit team knowledgeable in the client's business?
- Did management cooperate with the auditors?

Corporate scandals often produce tougher regulation and more rigorous enforcement. After the Enron and WorldCom debacles, the Sarbanes-Oxley Act of 2002 contained new provisions governing audits, auditing firms, audit committees and disclosure requirements for off-balance-sheet transactions, among many other new rules. The new law also held chairmen, CEOs and CFOs personally accountable for the financial reports, compelling them to be more diligent in their oversight of the auditor's work.

5. Develop multiple sources in the financial world

Hedge-fund managers, short sellers, analysts and researchers can be valuable sources for journalists because they delve deeply into the company financial and non-financial information and perform extensive due diligence for their clients.

WHAT DO YOU KNOW?

Quick Quiz

1. **Only one of the following financial disclosure filings must be audited. Which one is it?**
   A. Periodic earnings statement
   B. Annual financial statement
   C. Proxy statement

2. **When the auditor gives an "unqualified" opinion to a company's financial statements, it means:**
   A. The auditor does not endorse the statements
   B. The auditor has reasonable assurance that the reports are an accurate reflection of the financial state of the company
   C. The auditor declines to make a judgment

3. **Insider trading is illegal if:**
   A. The number of shares exceeds 10 percent of an investor's holdings
   B. The investor has confidential, material (significant), non-public information obtained from inside sources about the company and trades on that information
   C. The buyer or seller is related to a company insider

Answers: 1. B, 2. B, 3. B

Throughout 2011, Muddy Waters LLC, a short-selling research firm, criticized Chinese companies listed in the United States for allegedly overstating assets and revenues. (A warning to journalists, however: In a number of cases, internal investigations by the companies themselves disputed those allegations.)

However, Muddy Waters continued to fault the Big Four accounting firms — PricewaterhouseCoopers, Deloitte Touche Tohmatsu, KPMG and Ernst & Young — for poor oversight of the Chinese firms.

Regulators in a company's industry or sector also may be good sources.

(See Chapter 7 for more on potential sources for journalists.) ■

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CHAPTER 6

Finding the story behind the numbers

How can journalists, most of whom are not accountants and have little background in the specialty, learn to spot sophisticated accounting tricks, much less unearth outright lying and cheating by corporate executives?

Short of taking an accounting course, reporters can educate themselves on the terminology used in company financial reports and learn to interpret the numbers.

- A variety of educational tools can help journalists improve their knowledge, including a number of books (see Selected Resources, appendix). Tutorials and articles are available free on financial websites; see links in this chapter and in the Sources section at the end of the chapter.
- A free, self-directed course in reading financial statements especially developed for business journalists is available at the Donald W. Reynolds National Center for Business Journalism at Arizona State University: http://bit.ly/HRNIxk
- Another resource is "Deterring and Detecting Financial Reporting Fraud — a Platform for Action," issued by the US Center for Audit Quality in October 2010, available at: http://thecaq.org

Here are some other tips:

1. Start with the web

Check the company's own website; check the stock exchange where the company is listed; look for blogs related to the industry and for analysts' sites. Visit websites for regulatory agencies and check them frequently.

Information on the web includes:

- Key company statistics, including financial statistics such as revenue, earnings and share performance
- A public company's financial disclosure filings
- A summary of the company's competitors in its industry
- Summaries of analysts' opinions on the company, its strategy and the outlook for its share price. Some of this is not free.
- Information about the company's major shareholders, its officers and salaries for top officers
- Current company news and information, including press releases about current events
- Financial blogs with information about the company
- A company profile, including its history, strategy and major events

2. Dissect financial statements

Financial statements generally consist of:

- Balance sheet
- Income statement
- Cash flow statement
- Statement of shareholders' equity
- Notes to financial statements

Balance sheet: The balance sheet is often described as a "snapshot" of a company's financial statement at a certain moment — usually, the last day of the company's fiscal year. It is a key part of the company's financial statements and shows the assets the company has available to undertake operations and its outstanding liabilities.

The balance sheet expresses the relationship between assets (what the company owns) and liabilities (what it

Do you know how to go about researching companies that are incorporated offshore?

Consult the Investigative Dashboard, a web-based center for investigative reporters to find resources, share information and learn new tricks of the trade. Technical support provided by the International Center for Journalists. http://www.datatracker.org/

owes). What is left over is shareholder's equity, which is known, too, as "net worth" or "book value." Equivalently, it is share capital plus retained earnings minus treasury shares. Investopedia, the financial education website, defines shareholders' equity as the amount by which a company is financed through common and preferred shares.

Or, expressed as a formula:

Shareholders' Equity =
Total Assets - Total Liabilities
OR
Shareholders' Equity =
Share Capital + Retained Earnings - Treasury Shares

Current liabilities include accounts payable, short-term debt and the current portion of long-term debt, among other items. **Non-current liabilities** include notes and bonds payable, long-term debt and pension and post-retirement obligations, which may contain significant information.

Off-balance-sheet entities may be used to disguise losses or create false profits. For an introduction to off-balance-sheet entities — a favorite ploy in accounting fraud scandals in recent years — see: **http://bit.ly/IvAFGS**

For more detail on how to read and interpret a balance sheet, see: http://bit.ly/IFGGxw

Income statement: This might also be called "statement of income," "statement of earnings," or "statement of operating results." It presents the company's revenues and expenditures within the covered period, usually one fiscal year, and provides useful information on revenue growth if compared with last year's income statement. It also shows gross margin, expenses and net income changes.

Operating expenses are the usual costs a company incurs to support its main business activities. **Non-operating expenses** refer to the expenses related to the company's financing and investing activities.

The income statement measures profitability, not cash flow (see below). For an explanation of fundamental analysis used in income statements, definitions of terminology used in income statements and a sample income statement, see: http://bit.ly/IFH5jj

Cash flow statement: Many analysts and investors consider cash flow the most important of a company's financial statements. Public companies are required by most exchanges to report all cash inflows from ongoing operations, investments and financing activities, and cash outflows.

Cash inflows and outflows show where the company's cash comes from and how it is spent over the period of one year.

Cash flow can be positive even if the company is not profitable. It does not account for assets and liabilities, accounts receivable or accounts payable. It needs to be analyzed in conjunction with the other financial statements to provide a complete picture of a company's health.

In "Avoiding Future Enrons," the Columbia Journalism Review (CJR) noted that journalists reporting on deadline tend to focus on revenue and profit reported in the income statement.

"But studying cash flow figures, especially from operations, gives a much clearer view of how much money is actually coming in and out of a business in a given period, and can be more revealing," Anya Schiffrin wrote in the CJR article.

A company may be making a profit but still show negative cash flows from operations. One reason is that sales may be made on credit and the receipt of cash will depend on how reliably the payments are made later. Continuing negative cash flows from operations is a red flag. Without cash, a company cannot pay its employees or cover other running expenses.

Recurring negative operating cash flows are a bad sign as they indicate the company is not generating net cash from its normal operations. If this continues, the company would likely be in financial trouble in the near future.

Operating cash flows may also be artificially increased by the company stretching out or delaying payments. It will show in the cash flow statement as a decline in operating cash outflows. However, this is not sustainable as eventually the company's creditors will put pressure on the company for timely payments. A comparison of the "cash outflows from operatons" with the "accounts payable" in the balance sheet would reveal this.

For an explanation of cash flow and a sample cash flow statement, see: http://bit.ly/HRM3eE

Investopedia, the financial education website, advises investors to learn to recognize what it calls green, yellow and red flags that are often embedded in such areas of the annual report as "Summary of Significant Accounting Policies."

3. Look for stories on annual reports, periodic statements

The annual report, which includes the annual financial statements, usually contains many story ideas and may reveal new information about the company's strategy or its operations during the previous year. Often, the annual report is more revealing than the periodic earning reports companies file, because regulators require more information.

In addition to reading through the entire report, reporters should pay special attention to the year-end financial statements.

Raw numbers only rarely make intriguing stories, but as with any kind of reporting, it is the new information, glimpses into company strategy and potential changes in the company's operations that provide ideas for stories.

- Look for changes from one year to another in all of the numbers reported; percentage changes reveal more valuable information.
- Ask whether the changes make sense in light of the current economic environment.
- Study risk factors for potential story ideas. Is risk being properly assessed and prepared for? For example, in its 2007 annual report, the Coca-Cola Co. cited water scarcity and poor water quality, and the effect they could have on Coke's profitability.
- Read the footnotes. They often lead to further story ideas. As Columbia Journalism Review pointed out in "Avoiding Future Enrons," a careful reading of footnotes in Enron's financial reports could have prompted questions about the extent of the off-balance sheet partnerships and conflicts of interest. Another potential red flag is the relationships a company has with clients and suppliers, often referred to in footnotes.
- Look for any changes in the company's accounting policies, or the potential impact of complying with new accounting regulations.

  Investopedia, the financial education website, advises investors to learn to recognize what it calls green, yellow and red flags that are often embedded in such areas of the annual report as "Summary of Significant Accounting Policies." Learn how to recognize these: http://bit.ly/HJg8vC
- Look for the size of debt obligations in the next year and beyond, and consider what sources of funding

REPORTER'S NOTEBOOK

On the importance of journalists understanding the numbers:

"… it's shocking how few [reporters] actually understand the difference between price and yield. Hardly any business journalist actually covers the financing. If you cover a company and all of a sudden their borrowing costs go from 100 (basis points) over to 250 or 300 over [meaning investors believe the risk has increased substantially], and no one asks a question. There's a problem there when that happens and nobody asks a question. I think we have training issues in a huge way in our profession. We brought a knife to a gunfight."

— The late Mark Pittman, reporter for Bloomberg News

Source: Audit Interview, Ryan Chittum, Columbia Journalism Review

STORY **TOOLBOX**

When writing the bread-and-butter periodic earnings story for a listed company, compare the company's analysis of its performance in the press release to the numbers in the actual financial filing, and the company's discussion in the filing of the numbers.

The press release often puts a positive spin on certain numbers, and altogether ignores other numbers that may tell a different story.

The same is true for the annual report: The glossy photos and upbeat analysis are sometimes contradicted by the numbers in the financial statements, and it's the journalist's job to study the numbers rather than reporting the spin.

the company has.

- Study the section on lawsuits and other legal matters. Sometimes shareholders lodge the lawsuits, but suits by vendors, clients and competitors can also be a tip-off to allegedly shady practices, or at least an indication of dissatisfaction with the company.
- Often, the company's account of its prior year and discussion of future strategy simply put a positive spin on information already known, but sometimes story ideas can be buried in these discussions.
- "Management discussion and analysis," included in most annual reports and required by some securities regulators, provides management with an opportunity to explain past events and outline plans for growth. This section helps provide insights into management's style. The information in this section is unaudited.
- Are major company purchases or sales realistically valued?

For example, Fortis Healthcare India announced it was buying the overseas healthcare business of its family owners, Malvindor and Shivinder Singh, in September 2011. Soon afterward, investment analysts expressed concerns about whether the $665 million intra-group transaction really was fair for shareholders of the listed company.

An analysis by Economic Times of India questioned whether the company might be paying as much as a 20 percent premium for the business. The newspaper used regulatory filings, company presentations and press releases to arrive at its conclusions.

Many business journalists write pro forma stories about companies' periodic financial statements, or earnings. But a more critical reading of the financial statements can lead to enterprising stories that unearth telling details.

Learning to spot potential trouble spots in corporate actions or decisions is usually the path to good stories.

4. Ask uncomfortable questions

While it is unlikely that journalists by themselves can uncover fraudulent activity by rogue traders, they certainly can ask questions of banks and investment firms about their risk-management policies, the risk-management

See "Ten Tips to Spotting Trouble in the Companies You Cover" at:
http://bit.ly/HGol8e

WHAT DO YOU KNOW?

Quick Quiz

1. This statement gives a "snapshot" of the company's financial position at a particular moment.
A. The periodic earnings report
B. Balance sheet
C. Cash flow statement

2. Non-operating expenses are:
A. Expenses related to financing and investing activities
B. Expenses connected with normal business operations
C. Unexpected costs

3. Subtracting liabilities from a company's total assets yields:
A. Net income
B. Short-term debt
C. Shareholders' equity

Answers: 1. B, 2. A, 3. C

qualifications of executives and board members, and whether banks and other financial institutions have policies and systems to protect against unauthorized trades.

Though many of the corporate scandals of recent years were engineered by top executives, some shady dealings were the work of rogue employees who managed to hide their activities from their superiors until it was too late.

At U.K.'s Barings Bank plc, futures trader Nick Leeson was a star in the early 1990s, responsible in one early high-flying year for 10 percent of the bank's entire annual profits. But then the Asian financial crisis began to unfold, and losses piled up. Leeson managed to hide more than £800 million in losses in an obscure account.

His bosses began to uncover the dealings with a spot audit in 1995, but by that time, all of the bank's assets and its very future were on the line. Eventually, heads rolled, Leeson went to prison and Barings was sold.

Despite investigations and lessons learned from the Leeson case, another rogue trader caused similar problems for French banking giant Societe Generale many years later, in 2008. The tab for Jerome Keviel's rogue trades was £7 billion.

That same year, Kweku Adoboli, a trader for Switzerland's UBS AG's investment bank, was starting to hide his trading losses, which ultimately caused a $2 billion loss for UBS, discovered in 2011.

Adoboli was charged with fraud and false accounting, and governance experts immediately began questioning the banks' risk management and oversight. USB chief executive Oswald Gruebel at first said that USB had "one of the best" risk-management units in the industry. But he soon resigned, saying he was shocked that a trader was able to inflict multibillion-dollar losses through unauthorized trades.

5. Tips for spotting "shenanigans"

Detecting accounting gimmicks is not a job for amateurs, but accounting professor Howard M. Schlilit has tried to make it easier to recognize devious tricks. His book, "Financial Shenanigans" was first published in 1993 and most recently updated in 2010 (see Sources at the end of this chapter).

The following charts, used with permission, show where to look for gimmicks and fraud in financial reports. ■

Both charts from "Financial Shenanigans: How to Detect Accounting Gimmicks and Fraud in Financial Reports," Howard Schilit and Jeremy Perler, third edition, McGraw-Hill, 2010.

Financial Shenanigans

Earnings Manipulation

- Recording revenue too soon
- Recording bogus revenue
- Boosting income using one-time or unsustainable activities
- Shifting current expenses to a later period
- Employing other techniques to hide expenses
- Shifting current income to a later period
- Shifting future expenses to an earlier period

Cash Flow Shenanigans

- Shifting financing cash inflows to the operating section
- Shifting normal operating cash outflows to the investing section
- Inflating operating cash flow using acquisitions or disposals
- Boosting operating cash flow using unsustainable activities

Key Metrics Shenanigans

- Showcasing misleading metrics that overstate performance
- Distorting balance sheet metrics to avoid showing deterioration

Warning Signs: Breeding Ground for Shenanigans

- Absence of checks and balances among senior management
- An extended streak of meeting or beating Wall Street expectations
- A single family dominating management, ownership or the board of directors
- Presence of related party transactions
- An inappropriate compensation structure that encourages aggressive financial reporting
- Inappropriate members placed on the board of directors
- Inappropriate business relationships between the company and board members
- An unqualified auditing firm
- An auditor lacking objectivity and the appearance of independence
- Attempts by management to avoid regulatory or legal scrutiny

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CHAPTER 7

Writing and reporting tips

"I wish you and your families a slow and painful death."

— Fausto Tonna, former finance director of Italy's Parmalat SpA, to journalists as police led him from jail to court.

Journalists rarely get any thanks from the movers and shakers whose careers come to a screeching halt or who wind up in prison as a result of scandals uncovered by the press.

Some executives and directors see the journalist's role as serving the market or investors. Most journalists have a different view: The press as watchdog, with a professional duty to uncover and write about a company's activities, including corporate malpractice.

"The current crisis illustrates perfectly that insistent, drumbeat, muckraking reporting about systemic abuses in the lending industry, for one, would have provided the vital, long-term warnings that investors clearly lacked," Dean Starkman wrote in The Audit, a blog about the business press for the Columbia Journalism Review.

How do corporate governance issues dovetail with this watchdog responsibility? The answer is that often, corporate governance principles — or flagrant disregard for them — are at the heart of developing stories at companies. When scandals unfold, investors and regulators immediately ask one overriding question: "Where was the board?"

The chain of events in 2011 at Olympus Corp., Japan's camera and endoscope manufacturer, seemed to start out as a cultural clash between the company's British CEO and its Japanese board. At least, that's what Olympus chairman Tsuyoshi Kikukawa gave as the reason the company ousted Chief Executive Michael Woodward.

Before long, though, journalists — tipped by Woodward — learned that the real problem was that Woodward was trying to hold the board and former executives accountable for a series of questionable transactions designed to hide huge losses. Kikukawa was forced to resign as chairman, shareholders lodged lawsuits, regulators investigated and the Olympus board's failures — not a cultural clash between a British executive and a Japanese board, as the board had claimed — became the center of attention.

How to spot a corporate governance story

How do journalists recognize the corporate governance stories lurking behind breaking news, such as the sudden dismissal of a CEO, the "retirement" of a board chairman, or a sudden and unexpected shift in strategy?

Often such stories emerge at the same time that the company is going through a major change, whether it's a major acquisition, expansion or setback. Along with regulatory and financial issues outlined in Chapters 5 and 6, some other possible tip-offs are:

- Announcements of plans to buy companies or be acquired
- The selling off of divisions, brands or facilities
- Moves by directors to join other boards, resign from their companies or sell shares
- Moves by individual or institutional shareholders to challenge company policies or practices

Personality-driven stories about CEOs, clashes between board and management, disagreements between regulators and company officials or between employees and management and about shareholder activists' concerns have great audience appeal and potential for breaking news.

Journalists sometimes get caught up in the daily minutia of business reporting, and forget that some of the best stories involve people and relationships.

How to find the right sources

Many reporters who cover corporate governance issues call on experts who alert them to stories and are willing to comment on events at companies. These include staff members at corporate governance think tanks, academics who specialize in the topics, and members of corporate governance institutes at major business schools. (See Resources in the appendix section for contacts and websites.)

Academic studies by faculty and research fellows associated with university corporate governance programs can provide useful story tips and excellent background for stories. This Guide cites a number of academic papers on such cases as Mexico's TV Azteca, India's Satyam Computer Systems Ltd., Italy's Parmalat SpA and the U.S.'s Enron Corp., to name just a few. (See Sources section at the end of each chapter, and Selected Resources, appendix.)

Topics covered in working papers available on Harvard's corporate governance website in late 2011 alone included studies on excess pay clawbacks, risk-taking by nuclear power plants and staggered boards, among others.

Diligent research into footnotes, appendixes, explanations of accounting practices and other details in regulatory filings is a key component of breaking stories about companies, as Chapters 5 and 6 explain.

Other sources, both inside and outside of companies, can be equally important. Middle management at many companies, especially those in the finance departments, are often helpful. Every journalist loves to hear from whistleblowers, who can often be the route to uncovering a great story. Whistleblowers, however, come with drawbacks, including personal agendas and grudges, a sometimes limited viewpoint of company operations and a lack of rigorous fact-checking.

Getting Your Corporate Governance Story on the Front Page

It's the reporter's job not only to dig up stories, but to "sell" them to the editor, and convince the editor that the story deserves prominent play.

In the end, the story you pitch must be news.

Most journalists agree that the following eight elements grab editors' attention, and more important, attract readers:

Immediacy: Did board decision or company action occur today, or is it scheduled?

Proximity: How will the corporate governance matter affect the community, region or country? If companies are poorly governed generally in a country, can the economy grow in a sustainable manner over the long term?

Prominence: Is the chairman, CEO, or board director well known?

Oddity: Did the board approve purchasing a beach resort when its business is computer manufacturing?

Conflict: Is there dissension among the board directors, investors, other stakeholders, the government or senior management?

Suspense: Is there a deadline, for example, by which the company must prove that it is fiscally solvent to obtain new loans to stay in business?

Emotions: This news element — commonly called human interest — involves stories that stir our recognition of basic human needs, both psychological and physical.

Consequence: If conflicts of interest have led the board and senior management to make bad decisions, can the company stay in business? Are investors and markets adequately informed about those conflicts, and have they priced the consequences into the company's share value?

— Source: "Business Reporting Beyond Numbers: Looking for the Good, the Bad and the Ugly in Corporate Governance" Global Corporate Governance Forum
http://bit.ly/I9LEmZ

Portfolio managers, investors and analysts can also be excellent sources. Hedge-fund managers and short sellers often provide insight into complicated financial maneuvers and accounting practices that may escape the average business reporter.

Top union leaders, human resource consultants, corporate compensation experts and recruiting firms also can provide tips and expertise.

Look for plots and subplots

Journalists sometimes get caught up in the daily minutia of business reporting, and forget that some of the best stories involve people and relationships. As the family feuds detailed in Chapter 4 show, many corporate governance stories are about brother pitted against brother, stepchildren fighting with second wives and infighting among heirs and would-be heirs.

Staying on top of court filings is one way to discover such stories, and sometimes contain details that allow journalists to delve deeply into family relationships. Macau gambling kingpin Stanley Ho's several wives and children fought most of their battles over ownership of his empire in the courts, revealing juicy details in the supposedly dull filings.

Steer clear of jargon

Business stories that confuse readers are stuffed full of numbers, studded with jargon and characterized by rambling sentences.

Defining terms is one way to avoid using jargon. Sometimes technical terms cannot be avoided — "collateralized debt obligations (CDOs)" is a phrase that popped up frequently in the wake of the subprime mortgage meltdown. The New York Times explained it succinctly and clearly: *"Collateralized debt obligations, or CDOs, are created by banks that pool together otherwise unrelated debt-instruments, like bonds, and then sell shares of that pool to investors."*

As with any story, researching the background, getting insight from experts in the field and writing clearly are what attract readers.

- First rule: Understand what you're writing about
- Don't "bluff," or pretend to know more than you do
- Count the number of clauses, commas and semicolons. Try streamlining the writing by simplifying.

A journalist who thoroughly understands the story is more likely to write a clear, focused article, and to concentrate on the points that most interest readers.

Editor's Tip Sheet

Editors can help reporters learn to spot compelling corporate-governance issues in routine business stories.

Be alert for the story-behind-the-story in typical business events. Often, they are prompted by deeper corporate-governance issues. (These topics are treated in more depth in previous chapters of the Guide.)

- Appointments or dismissal of top executives or board members
- Significant changes in company ownership (share issues and buy-backs; notable owners, including institutional investors; share classes and other changes in the structure or distribution of share ownership; mergers and acquisitions; family ownership to dispersed ownership or privatization)
- Changes in compensation of top executives or directors
- Unusual movements in profits and performance that may reveal accounting or financial reporting scandals or demonstrate that the company is well-run
- New strategic direction for the company, such as entry into new markets or product lines
- Company is in persistent decline or trouble, which may intensify conflicts within management and the board over how the company can survive
- Theft, corruption or misuse of company funds
- Shareholder conflicts with the board and management
- Disagreements with community leaders, interest groups, vendors or labor over environmental, workplace and public health issues, among others
- Changes in stock exchange listing rules. What precipitated them and why?

Almost any business story can be enhanced by using video or audio along with the print or web version of the story. For a business reporter, the first question is: What medium best tells the story — a video clip, photo or series of photos with explanatory text or an audio narration?

How to choose a format for the story

Corporate governance stories do not follow a formula. They're often about human drama — personality conflicts, power struggles, greed, fear, status and power. The nature of the story dictates the format — news, feature, news-feature, profile, investigative.

In choosing a format, ask three questions:

- What's the best way to tell the story, to grab the reader's interest and then hold on to it?
- What format is most appropriate for the material in this story?
- Why should the reader care about this story?

Here are some general definitions of various kinds of stories.

News

If the story is fresh news, not previously reported, about something that has happened or is about to happen, the format will be the traditional news story. The lead tells the reader the most important information first and arranges the rest of the information in inverted pyramid style.

In a business story, it's particularly important to choose carefully the key numbers for the lead, and avoid packing the first sentences with too many numbers. *Examples: Stories about the resignation or firing of a top company officer; a major acquisition or decision to sell a line of business; shareholder initiatives.*

Feature

Stories that do not have a strong time element, or that are about general topics or about a particular angle on a news story, are features. For example, a story about Hewlett-Packard's board was a feature or background story, which appeared a few days after the company tossed out its CEO. *Examples: Stories about changes in company strategy or direction; backgrounders about possible heirs to top officer spots; issues surrounding succession, especially in a family business.*

News-feature

Some stories fall in the gray zone between news and features. The topic may be a current event or person in the news, but the story takes a broader view, with more behind-the-scenes details than can be included in a news story. *Examples: How new directors have influenced company policy and decision-making; how a company is rebuilding after an accounting scandal or share price decline.*

Profile

A profile concentrates on one person and attempts to give a fully rounded portrait of that person. It may be based on interviews with the subject, but should also include other sources — colleagues, family, friends, even rivals. A profile can also focus on a particular business or company, if there is something distinctive or newsworthy about the company. *Examples: Younger family members in a family business; a prominent shareholder who challenges company policies or decisions.*

Investigative

The investigative story has elements of both the news and feature story, and can be written effectively in either style. To be considered investigative, a story must uncover wrongdoing and bring it to light for the first time. It is usually lengthier than the typical news or feature, and may be presented as a series of stories over a number of days, with sidebars. Sidebars are smaller stories accompanying the main story, and each concentrates on a particular sub-topic addressed in the story, giving more detail or background.

Examples: In-depth stories about company accounting practices can be investigative if they uncover suspicious or even illegal maneuvers. For a good example, see The Globe and Mail's story on Sino-Forest Corp.'s actual timber holdings in China (Chapter 5).

Opinion column

Journalists can question company strategy, criticize management and the board and speculate in columns, where they have much more leeway than in straight, factual news stories. In this column by Tamal Bandyopadhyay in India's Livemint.com, notice how the writer manages to raise questions about the stewardship of Praval Kumar Tayal, under pressure to give up control of the Bank of Rajastham. http://bit.ly/I9LOuC

Use these tools for story structure

In constructing corporate governance stories, it is often a good idea to break down complex information into smaller "bites," or pieces, for readers and viewers.

List technique

Often used for budget stories, this method also lends itself to other stories that include a number of highlights or important points. This method starts with a traditional lead — usually a news lead — followed by a few paragraphs of backup information, then a list of supporting points.

Tick tock

This slang term (referring to the sound of minute or second hands on a clock ticking off time) is used to describe a background story that traces chronologically the development of a major news event, usually from the viewpoint of the principal players.

Sections technique

This is primarily a visual device that serves to divide a story into sections, like book chapters, to alert the reader to various kinds of subject matter. The sections are separated by graphic device such as a large dot or large capital letter, or by subheads.

Wall Street Journal formula

This technique, named for the newspaper that developed and perfected it, is usually used for a feature or news feature story. It begins with a "soft" or feature lead that focuses on a person, scene or event. The story usually begins with the specific and proceeds to the general. It must have, in the third or fourth paragraph, a "nut graph," which states the main theme or focus of the story.

Enhance the story with multimedia

Almost any business story can be enhanced by using video or audio along with the print or web version of the story, often by adding a human voice and face to the text. For a business reporter, the first question is what medium best tells the story — a video clip, photo or series of photos with explanatory text or an audio narration?

The decision depends partly on what "visuals" are available for the print story. Sources may be interviewed on camera, for example, for a video. Or they can be interviewed and recorded for a podcast — an audio file that the audience can download from a website and listen to on a computer or on an MP3 player. A series of photos with audio narration — a slideshow — can be a good way to explain complicated technology.

Many newsrooms are now equipped with their own digital media departments, and if you're lucky enough to work in this environment, your editor may send a videographer or reporter or sound technician along on an assignment.

REPORTER'S NOTEBOOK

At one time, journalists relied heavily on analysts for tips and insights. That changed, however, after Enron Corp. imploded. Analysts had been largely uncritical and even euphoric about Enron. As it turned out, many of the analysts' companies were receiving fees or being paid for contract work with Enron. Such analysts are not independent and tended to spin positive news.

"Business reporters should probably not quote analysts at all," Gretchen Morgenson of The New York Times was quoted as saying in a 2002 Columbia Journalism Review story, "Enron: Uncovering the Uncovered Story."

"If they do quote them," Morgenson continued, "they should at least identify the firm and the firm's relationship to the company that they're talking about."

In 2012, Morgenson elaborated on that viewpoint, saying: "Specifically, many analysts at large investment banks have been known to write favorable research about companies for whom their firms conducted other business, such as raising capital from investors or providing mergers and acquisition advice. This conflicted position exploded into public view in the aftermath of the Internet bubble, when investigations into analysts' work uncovered internal e-mails disparaging companies that the same analysts were recommending to investors."

Ethical considerations for business reporters are not much different from those for reporters covering politics, sports or any other topic, but there are some special considerations and perhaps more opportunities for conflicts of interest to arise.

Many reporters, however, have bought simple, inexpensive videocameras or digital recorders so that they can collect their own digital media to post online.

Some reporting requires courage

Journalists who reveal wrongdoing while digging into company finances and operations may find themselves facing pressure from large corporations and wealthy business people.

Reporters may even find that their editors or publishers shy away from tough stories or investigative journalism, perhaps for fear of offending big advertisers, influential business people or powerful politicians. Making a case for publication can be difficult, but journalists who can show that their stories are meticulously researched and fair to all sides will have a better chance of convincing higher-ups that a story deserves to be published.

The best defense against efforts to intimidate or thwart publication is accuracy. But sometimes, even that is not enough.

A story involving a powerful businessman in Indonesia caused a firestorm for Bambang Harymurti, then chief editor of Tempo, Indonesia's largest news magazine. The story detailed accusations that a suspicious fire in a market in Jakarta in 2003 might have been connected to a developer's plans to build an expensive commercial shopping center on the site.

The businessman behind the development, Tomy Winata, sued Harymurti and two of the editor's colleagues for civil defamation. Then the government got into the act, charging criminal defamation and asking for two-year sentences for the journalists. The charges produced an outcry from journalists around the world, who said that prosecuting the Tempo staff members under criminal law rather than the press law was a major setback for democracy and press freedom in Indonesia.

Harymurti was found guilty of libeling the businessman and sentenced to a year in prison. The two reporters were acquitted. But the Supreme Court of Indonesia ultimately reversed the lower-court decision and said the journalists should have been tried under the press law.

Lawsuits represent a major threat to journalists, but pressure from corporations and public relations representatives are far more common occurrences. Negative stories can prompt an immediate reaction, especially if the subject of the story is a major advertiser. Support from editors and owners is critically important to resisting such pressure.

A number of organizations provide resources and support for investigative journalism. These include tutorials, self-directed courses and examples of investigative journalism. Among these organizations are:

Center for Investigative Reporting: http://cironline.org/

STORY **TOOLBOX**

Where to find early tipoffs for stories?

Social media has become a favorite source for journalists, who regularly check financial blogs, sign up for "tweets" and check social networks such as Facebook.

Felix Salmon's financial blog for Reuters, "A slice of lime in the soda," often has breaking news about company events and management changes. http://blogs.reuters.com/felix-salmon/

Zero Hedge is another blog that got journalists' attention by delving deeply into sometimes arcane financial issues that are not the stuff of daily mainstream journalism, but can serve as a source of ideas for other journalists. http://www.zerohedge.com/

Both Salmon's blog and Zero Hedge have established a reputation for accuracy and reliability, but journalists should exercise the usual caution in checking social networks and blogs.

Investigative Reporters and Editors: http://www.ire.org/

Investigative Dashboard: http://www.datatracker.org/

International Center for Journalists: http://www.icfj.org/

International Journalists' Network (ijnet): http://ijnet.org/

International Consortium of Investigative Journalists: http://www.publicintegrity.org/investigations/icij/pages/resources/

The Poynter Institute: http://www.poynter.org/

Philippine Center For Investigative Journalism: http://pcij.org/

Overcoming ethical challenges

Ethical considerations for business reporters are not much different from those for reporters covering politics, sports or any other topic, but there are some special considerations and perhaps more opportunities for conflicts of interest to arise.

Product giveaways are a frequent enticement from companies looking for favorable coverage. While journalists may certainly accept the loan of a product to test or review it, the product should be returned to the company. Accepting gifts of computers, mobile devices or any such item can compromise the journalist's objectivity and create a conflict of interest.

In many countries, journalists have a long tradition of accepting "envelopes" containing money, sometimes ostensibly to cover expenses. Most international news organizations forbid their employees from taking such gifts. But the tradition persists in media companies where reporters are paid little and regard the favors as a supplement to their salary.

Journalists who resist the temptation to take gifts or favors are in a much better position to win the trust of their audience and establish credibility.

Most major news organizations do not allow business reporters or their immediate families to own shares in the companies they cover, or any companies they might cover in the future. They must not privately divulge information they pick up in the course of covering companies to others who have some interest in the companies, whether investors, analysts or anyone else.

Share prices can move up or down solely on news or rumors, providing another reason journalists need to be especially careful about verifying all information thoroughly. Consumer views, investor actions and the reputation of managers and board members can all be affected by what appears in the media. That doesn't mean reporters should be overly cautious, only that they need to apply the highest professional standards to their reporting and writing.

Such considerations also point to the critical importance of writing fair, balanced stories that adequately cover all sides. ■

WHAT DO YOU KNOW?

Quick Quiz

1. A business reporter regularly covers a major steel company. His parents own a considerable amount of the company's shares. He knows the company is experiencing some major difficulties that could affect the share price dramatically. What should he do?

A. Tell his editor about his parents' share holdings and ask to be removed from covering that company
B. Keep reporting as fairly as possible on the company. No need to inform the editor
C. Tell his parents to cash in their share immediately

2. The slang term for the type of story that recounts chronologically the background of a major event is called

A. Investigative
B. Tick tock
C. Sections technique

3. Reporters should be somewhat skeptical about using analysts as sources for stories, according to some reporters, because:

A. Analysts are not necessarily independent from the companies they cover
B. Analysts are not particularly knowledgeable
C. Many analysts want to be quoted off the record

Answers: 1. A, 2. B, 3. A

SOURCES *Chapter 7*

Editor's note: The following sources were consulted in the preparation of Chapter 7. Most of the websites are accessible to any reader. Stories in certain publications, such as The Wall Street Journal and the Financial Times, require a subscription for access. The New York Times provides a limited number of archived materials per month to each viewer.

ARTICLES AND PAPERS

Tamal Bandyopadhyay, "Of Corporate Governance and Bank of Rajasthan," LiveMint.com, Nov. 21, 2011. http://bit.ly/I9LOuC

Anne Molyneux, "Corporate Governance: Investigative Business Reporting," presentation, May 2011, Hanoi. Sponsor: Global Corporate Governance Forum.

Takashi Nakamichi and Atsuko Fukase, "Japan Central Banker Bemoans Olympus Affair," The Wall Street Journal, Nov. 16, 2011. http://on.wsj.com/IM8VhF

Dean Starkman, "What is Financial Journalism For?" The Audit, Columbia Journalism Review, Jan. 13, 2009. http://bit.ly/HDZts0

Mark Tran, "Ex-Parmalat Finance Chief Lambasts Journalists," The Guardian, Jan. 5, 2004. http://bit.ly/IEZAHl

Paul Wolfowitz, "The First Draft of Freedom," The New York Times, Sept. 16, 2004. http://nyti.ms/ISPbr0

Ben Worthen and Joann S. Lublin, "Crisis Unfolds at H-P Over CEO," The Wall Street Journal, Sept. 22, 2011. http://on.wsj.com/HEhew9

"Indonesia Editor Jailed for Libel," BBC News, Sept. 16, 2004. http://bbc.in/J8GEga

"The Supreme Court Overturns One-Year Sentence Against Bambang Harymurti," Reporters Without Borders, March 8, 2006. http://bit.ly/IFMmr9

BOOKS AND STUDIES

"Business Reporting Beyond the Numbers: Looking for the Good, the Bad and the Ugly in Corporate Governance," Lessons Learned October 2009, Global Corporate Governance Forum and International Finance Corporation, World Bank Group.

Journalists who want to delve more deeply into corporate governance will find a wealth of resources online. Within your country or region, the Institute of Corporate Governance or Directors (some are listed) may offer courses and speeches in addition to background materials and other resources. Below is a selection of some resources, a sample of the many available. See also specific organizations that aid journalists with information and resources on investigative reporting.

CORPORATE GOVERNANCE OVERVIEW

International Organizations

CFA Institute
http://www.cfainstitute.org
A global, not-for-profit organization comprising the world's largest association of investment professionals who have passed examinations to become chartered financial analysts. Offers access to experts worldwide, publishes background material and academic research on accounting, auditing, corporate governance ("The Corporate Governance of Listed Companies: A Manual for Investors," Second Edition) and other investment topics (also webcasts, podcasts).

Global Corporate Governance Forum
http://www.gcgf.org/
Dedicated to corporate governance reform in emerging markets and developing countries, the Forum provides training materials on corporate governance, publishes research on corporate governance issues, and reports periodically on its activities worldwide.

International Finance Corporation
www.ifc.org/corporategovernance
IFC, a member of the World Bank Group, is the largest global development institution focused on the private sector in developing countries. Website provides extensive resources on corporate governance around the world, particularly about family-owned enterprises (FOEs) and state-owned enterprises (SOEs).

International Chamber of Commerce
http://www.iccwbo.org
ICC activities cover a broad spectrum, from arbitration and dispute resolution to making the case for open trade and the market economy system, business self-regulation, fighting corruption or combating commercial crime.

International Corporate Governance Network
http://www.icgn.org
Global membership organization operating in 50 countries to raise standards of corporate governance worldwide. ICGN is sought for its views on corporate governance issues. Its "In the News" section provides good insights into trends in corporate governance stories.

International Integrated Reporting Council
http://www.theiirc.org/
Comprised of leaders from the corporate, investment, accounting, securities, regulatory, academic and standard-setting sectors, as well as civil society. Publishes reports.

Islamic Financial Services Board
http://www.ifsb.org/
Promotes soundness of Islamic financial services industry by issuing global standards and guiding principles banking, capital markets and insurance sectors.

Organization for Economic Co-operation and Development (OECD)
http://www.oecd.org/topic/0,3699,en_2649_37439_1_1_1_1_37439,00.html
Headquartered in France, has 34 member countries. The OECD Principles of Corporate Governance are the foundation of corporate governance laws, regulations and best practices worldwide. Other resources include statistics, studies, papers and global information about corporate governance.

Transparency International
http://www.transparency.org
A global civil society organization leading the fight against corruption through a global network including more than 90 locally established national chapters and chapters-in-formation.

World Bank Reports on the Observance of Standards and Codes (ROSCs)
http://www.worldbank.org/ifa/rosc.html
ROSCs help to better identify weaknesses that may contribute to economic and financial vulnerability, foster market efficiency and discipline, and ultimately contribute to a global economy, which is more robust and less prone to crisis.

REGIONAL ORGANIZATIONS

Africa (Sub-Saharan)

FITC - Nigeria (Financial Institutions Training Centre)
http://www.fitc-ng.com/index.asp
Designs and delivers training programs in general management, leadership development, banking and finance.

Institute of Directors - Southern Africa
http://www.iodsa.co.za/
Aims to bring about development and lifelong learning through internationally recognized director development and educational programs.

Asia and The Pacific

Asian Corporate Governance Association
http://www.acga-asia.org/
Independent, nonprofit membership organization works with investors, companies and regulators on effective corporate governance practices in Asia.

Bangladesh Enterprise Institute
http://www.bei-bd.org/
Nonprofit, non-political research center that promotes issues of importance to the private sector; seeks to influence policy for the development of a market-oriented economy.

The Institute of Company Secretaries of India
http://www.icsi.edu/
Only recognized professional body to develop and regulate the profession of Company Secretaries in India.

Pakistan Institute of Corporate Governance
http://www.picg.org.pk/index.php
Public-private partnership to promote good corporate governance practices in Pakistan.

Europe

European Bank for Reconstruction and Development (EBRD)
http://www.ebrd.com/pages/homepage.shtml
International financial institution that supports projects in 29 countries, from central Europe to central Asia. Promotes entrepreneurship and fosters transition towards open and democratic market economies.

European Confederation of Directors' Associations
http://www.ecoda.org/about.html
Aims to promote directors' skills, professionalism and impact on society.

European Corporate Governance Institute
http://www.ecgi.org/index.htm
Provides a forum for debate and dialogue among academics, legislators and practitioners, focusing on major corporate governance issues.

Baltic Institute of Corporate Governance
http://www.corporategovernance.lt/
Pursues global-class transparency and competitiveness of Baltic public, private and state or municipality owned companies through corporate governance.

Institute of Directors in the UK
http://www.iod.com/home/default.aspx
Supports, represents and sets standards for company directors.

Slovenian Directors' Association
http://www.zdruzenje-ns.si/zcnsweb/vsebina.asp?s=381&n=1
Only membership organization in Slovenia representing supervisory board members. Provides education, certification, research, professional standards, publishing and consulting services to members.

Latin America and The Carribbean

Brazilian Institute of Corporate Governance
http://www.ibgc.org.br/Home.aspx
Central forum for introduction and dissemination of the corporate governance concept and best practices in Brazil.

Center for Excellence in Corporate Governance (El Centro de Excelencia en Gobierno Corporativo)
http://ols.uas.mx/cegc/
Nonprofit that promotes excellence in corporate governance in Mexico. Sponsors programs providing updated methodology and tools of corporate governance.

Center for Corporate Governance and Capital Markets (Centro de Gobierno Corporativo y Mercado de Capitales)
http://www.cgcuchile.cl/
Includes representatives of civil society, academia and private sector to promote better corporate governance practices in Chile.

The IGCLA.net
http://igcla.wordpress.com/
Informal association of Corporate Governance Institutes from Latin America established at Corporate Governance Roundtable organized by OECD and Global Corporate Governance Forum.

Private Sector Organization of Jamaica
http://www.psoj.org/
Its Corporate Governance Committee aims to promote best practices to leaders of business enterprises.

Procapitales (Asociación de Empresas Promotoras del Mercado de Capitales
http://www.procapitales.org/
Trade association of agents in Peruvian capital market; promotes good corporate governance practices.

Middle East and North Africa

Corporate Governance Responsibility Forum
http://www.cgrforum.com/Public/Main_English.aspx?site_id=1&page_id=308
Regular event gathering of global experts on corporate governance and responsibility together with business leaders in the MENA region.

Hawkamah, the Institute for Corporate Governance
http://www.hawkamah.org/
Aims to promote corporate sector reform and good governance, assist the countries of the MENA region in developing corporate governance.

Lebanese Transparency Association
http://www.transparency-lebanon.org/
First Lebanese NGO focusing on curbing corruption and promoting the principles of good governance.

North America

National Association of Corporate Directors
http://www.nacdonline.org/
Aims to advance exemplary board leadership — for directors, by directors. It is focused on meeting the needs of board members and supporting directors to perform more effectively and efficiently.

Council of Institutional Investors
www.cii.org
The nonprofit, nonpartisan association of pension funds and other employee benefit funds, foundations and endowments (with combined assets that exceed $3 trillion) has publications, comment letters and other resources to learn more about corporate governance.

■ ACADEMIC INSTITUTIONS AND THINK TANKS

Many universities have established research centers for corporate governance. These websites publish research, sponsor public forums and other events and recommend other websites. These institutions often make available experts to provide background and analysis to journalists.

Center for Corporate Governance, Tuck School of Business, Dartmouth
http://mba.tuck.dartmouth.edu/ccg/
Research focuses on understanding how international differences in capital markets, ownership structures, and legal traditions affect the optimal design of financial contracts. The center also examines potential conflicts between shareholders (as owners of the firm) and other corporate constituents.

Centre for Corporate Governance, London Business School
http://www.london.edu/facultyandresearch/researchactivities/centre-forcorporategovernance.html
Access faculty and monitor research through news updates.

Centre for Corporate Law and Securities Regulation, University of Melbourne
http://cclsr.law.unimelb.edu.au
Undertakes and promotes research on corporate law and securities regulation. Provides links to corporate governance sites worldwide.

The INSEAD Corporate Governance Initiative
http://www.insead.edu/facultyresearch/centres/governance_initiative/
Sponsors cutting-edge research and teaching tailored to the needs facing board members in an international context. Provides case studies and access to experts and alumni.

Knowledge@Wharton
http://knowledge.wharton.upenn.edu/
Analysis of news events affecting economies from business school's faculty.

National University of Singapore Governance and Transparency Index
http://bschool.nus.edu/CGIO/OurProjects/GovernanceTransparencyIndex.aspx
The index evaluates the quality of corporate governance and transparency for more than 700 companies in Asia.The governance component covers board matters, remuneration, accountability and audit. The transparency measurement focuses on how companies communicate with their shareholders.

Oxford University Centre for Corporate Reputation Case Studies
http://www.sbs.ox.ac.uk/centres/reputation/research/Pages/CaseStudies.aspx
Access research and faculty on the reputational consequences of corporate behavior, including relationships between journalists and corporate decision-makers.

Sabanci University Corporate Governance Forum of Turkey
http://cgft.sabanciuniv.edu/about/background
Contributes to the improvement of corporate governance framework and practices through scientific research, supports the policy development process by active engagement, encourages and facilitates dialogue between academicians and practitioners, and disseminates research.

Weinberg Center for Corporate Governance, University of Delaware
http://www.delawarecorporategovernance-blog.com/
Provides a forum for business leaders, members of corporate boards, the legal community, academics, practitioners, graduate and undergraduate students, and others interested in corporate governance issues to meet, interact, learn and teach

Yale School of Management
Millstein Center for Corporate Governance
http://millstein.som.yale.edu/
Leading global resource for studying the premise that corporations should serve society responsibly, ethically and transparently. Efforts are directly related to understanding the capacity of corporations and institutional investors around the world to deal with strategy and risk, and their alignment with each other and with the interests of beneficial owners.

SPECIFIC TOPICS

Accounting and Auditing

Accounting and audit firms provide background information on corporate governance and often conduct research on issues companies confront. While the focus of their websites is on boards that are existing or potential clients, their updates and analyses can be useful. Professional groups offer research and may serve as forums for discussion. They may help journalists find accounting and auditing experts.

Deloitte Center for Corporate Governance
http://www.corpgov.deloitte.com/site/us/template.PAGE/

Ernst & Young – Governance and Reporting
http://www.ey.com/US/en/Issues/Governance-and-reporting

Institute of Chartered Accountants of England and Wales
http://www.icaew.com/
Professional membership organization supporting over 138,000 chartered accountants worldwide. Publishes reports and blogs and hosts webinars on accounting and governance issues. Posts news updates.

International Federation of Accountants
http://www.ifac.org
Promotes best practices and speaks out on public interest issues for its 2.5 million members in 127 countries and jurisdictions. Publishes reports and issues comments on regulatory and legislative proposals.

KPMG Audit Committee Institute
http://www.kpmginstitutes.com/aci/

PricewaterhouseCoopers (PwC) Center for Board Governance
http://www.pwc.com/us/en/corporate-governance

Corporate Governance Policies in Company Statements

Companies may publish their corporate governance policies on their websites and include a statement in their annual reports. Institutional investors are requiring companies they hold shares in to provide written, disclosed governance procedures and policies. The following examples give a flavor of corporate governance policies that may be found in company statements. Please note that this information is for illustrative purposes only and does not endorse or guarantee the particular standards of corporate governance in the companies listed below.

Access Ban
http://www.accessbankplc.com/Pages/page.aspx?value=45#
A large financial services provider based in Nigeria with interests across Africa and in the United Kingdom.

BHP Billiton
www.bhpbilliton.com
One of the world's largest independent mining, oil and gas companies based in Australia.

Hysan Development Company Limited
http://www.hysan.com.hk/eng/index_company.html
A leading property investment, management and development company based in Hong Kong.

Natura
http://www.natura.net
A leading Brazilian cosmetics company which emphasizes sustainability in its governance and products.

Petronas
http://www.petronas.com.my/Pages/default.aspx
An integrated international oil and gas company, wholly owned by the Government of Malaysia.

Tata Group
http://www.tata.com
The Code of Conduct of this prominent Indian company covers more than 100 operating companies in seven business sectors globally.

Turkcel
http://www.turkcell.com.tr/site/en/turkcellhakkinda/Sayfalar/genel.aspx
A prominent international mobile communications company in Turkey.

Dispute Resolution

Centre for Effective Dispute Resolution
http://www.cedr.com
CEDR is an independent, non-profit organization with a mission to cut the cost of conflict and create choice and capability in dispute prevention and resolution. CEDR provides mediation, consultancy, and training services.

Ethics

Ethics Institute of South Africa
http://www.ethicsa.com
Non-profit that conducts research, provides training and advisory services, and conducts assessments and certifications. Research available online and resource center has books and other materials available on-site only.

Ethisphere
http://ethisphere.com
International think-tank dedicated to the creation, advancement and sharing of best practices in business ethics, corporate social responsibility, anti-corruption and sustainability. Provides rankings, holds events including webcasts, and publishes background materials.

Globethics.net
www.globethics.net
A worldwide ethics network based in Geneva that provides an electronic platform for ethical reflection and action. Online library offers free access to journals, encyclopedias, e-books, and other resources. Journalists can expand contacts through networking opportunities.

Markkula Center for Applied Ethics
http://www.scu.edu/ethics
Center for Santa Clara University conducts research and holds forum on ethical issues.

Rio Tinto Statement of Business Practices
http://procurement.riotinto.com/ENG/supplierregistration/34_the_way_we_work.asp

Standard Approach to Sustainability
http://www.standardchartered.com/en/sustainability/our-approach/

Thrivent Financial Code of Conduct
https://www.thrivent.com/aboutus/privacy/conduct.html

Institutional Investors

Aberdeen
www.aberdeen-asset.com

Bradesco
http://www.bradescori.com.br/site/conteudo/governanca/default.aspx?secaoId=730

CalPERS
http://www.calpers-governance.org/

Hermes
http://www.hermes.co.uk/Portals/8/The_Hermes_Ownership_Principles_US.pdf

Ratings

Several organizations provide independent assessments of a company's compliance with corporate governance, which may form the basis of a story.

CLSA
https://www.clsa.com/index.php
The independent brokerage and investment bank publishes, in collaboration with the Asian Corporate Governance Association, the most comprehensive assessment of corporate governance performance, issues and trends in Asia.

GovernanceMetrics International
http://www2.gmiratings.com/
U.S. based, covers more than 20,000 companies globally. Provides analysis, reports, research and ratings. Subscribe to FeedBurner blog for updates.

Corporate Social Responsibility, Sustainability

Investors, interest groups and governments are pressing companies to adopt policies and practices that will ensure the company's long-term sustainability and minimize its impact on society and the environment. The following organizations may provide background on issues and some assess companies for their social responsibility.

Caux Round Table
http://www.cauxroundtable.org/
An international network of business leaders working to promote a moral capitalism. The CRT Principles apply fundamental ethical norms to business decision-making.

Center for International Private Enterprise
http://www.cipe.org
CIPE works with business leaders, policymakers, and journalists to build the civic institutions vital to a democratic society. Its key program areas include: anti-corruption, advocacy, business associations, corporate governance, democratic governance, access to information, the informal sector and property rights, and women and youth.

Equator Principles
www.equator-principles.com
Based on IFC and World Bank standards, these principles established a credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions.

Extractive Industries Transparency Initiative
http://eiti.org/
Sets the global standard that ensures accountability and transparency of the revenues from a country's extractive sector.

The Global Reporting Initiative
http://www.globalreporting.org/
A non-profit organization that promotes economic, environmental and social sustainability. GRI provides all companies and organizations with a comprehensive sustainability reporting framework that is used worldwide.

International Institute for Environment and Development (IIED), Participatory Learning and Action Series
www.iied.org
IIED supports journalists in a broad range of media to report more often and more accurately on the links between environment and development in ways that are relevant to their various audiences.

Responsible Investor
http://www.responsible-investor.com/
The only dedicated news service reporting on responsible investment, ESG (environmental, social and governance) and sustainable finance issues for institutional investors globally. Site provides free access to limited number of articles.

SustainAbility
www.sustainability.com
Founded in 1987, the business helps clients and partners better understand and create business and societal value in response to issues from consumption, transparency, stakeholder engagement and strategy to innovation and transformation.

United Nations Global Compact
http://www.unglobalcompact.org/
This is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment and anti-corruption.

ONLINE LIBRARY

Open-Access Text Archive
http://archive.org/details/texts
An Internet library of books, articles and other materials in digital format. Also provides an extensive list of links for many online libraries established by nonprofit organizations, universities and others worldwide.

GLOSSARY

Definitions are reprinted or adapted from several sources, including Practical Guide to Corporate Governance, Organization for Economic Cooperation and Development (OECD), Businessdictionary.com and Investopedia.com

A

Accountability: In corporate governance terms, it is the responsibility of a board of directors to shareholders and stakeholders for corporate performance and actions of the corporation. It is the concept of being responsible for all actions performed by the company's management and reporting this information to stakeholders. It also refers to the accountability of management to the board for its actions in running the business.

Accounting Standards (also see Generally Accepted Accounting Principles, GAAP): A widely accepted set of rules, conventions, standards and procedures, as established by accounting standard setters, for recording and reporting financial transactions and information.

Acquisition: Gaining control of another corporation by share purchase or exchange. An acquisition can be hostile or friendly.

Agency Conflicts: Problems that can arise when a principal hires an agent to act on his behalf, giving the agent authority and decision-making power.

Agency Costs: Costs incurred by an organization for problems related to divergent management-shareholder objectives. The costs consist of two main sources: costs inherently associated with using an agent (e.g., the risk that agents will use organizational resources for their own benefit) and costs of techniques used to mitigate the problems associated with using an agent (e.g., the costs of producing financial statements or the use of share options to align executive interests to shareholder interests).

Agency Theory: A theoretical framework used to describe the relationship of power and interest between someone, the principal, who hires a second party, the agent, to act on his behalf.

American Depositary Receipt (ADR): A security issued by a U.S. bank in place of the foreign shares held in trust by that bank, facilitating the trading of foreign shares in U.S. markets.

Annual General Meeting (AGM) (Shareholders' Assembly): A shareholders' gathering, usually held just after the end of each fiscal year, at which shareholders, directors, and management discuss the previous year, the financial statements and the outlook for the future. At the meeting, directors are elected and other shareholder concerns may be raised. The AGM is the main opportunity for shareholders to put questions directly to the directors of the company and to exercise their voting and decision-making power.

Annual Report: A document issued annually by companies to their shareholders. It contains information on financial results and overall performance during the previous fiscal year and comments on the future outlook. The Annual Report should include the Corporate Governance Report and other narrative reports, such as the CEO's Report.

Auditor's Opinion: A certification that accompanies financial statements, provided by independent auditors who audit a company's financial statements and records. The opinion indicates whether or not, overall, the financial statements present a fair reflection of the company's financial condition.

Audit: Is a review of the historical financial statements to enhance the degree of confidence in them. Then, examination and verification of a company's financial and accounting records and supporting documents by a competent, qualified professional and independent external auditor is to assure readers that they are in accordance with applicable reporting and accounting requirements, are free from material misstatement due to fraud or error and are true and fair representation of the company's financial condition.

Audit Committee: A committee constituted by the board of directors, typically charged with oversight of company reporting and disclosure of both financial and non-financial information to stakeholders. The committee usually is responsible for selecting and recommending the company's audit firm to be approved by the board/shareholders. Usually the Audit Committee is also responsible for the control environment of the company and risk oversight, if there is no separate risk committee of the board.

B

Board of Directors: The collective group of individuals elected by the shareholders of a company to direct and control the company. They define vision and mission, set the strategy and oversee the management of the company. The board is charged with selecting the chief executive officer (CEO), defining the compensation package of officers and setting the long-term objectives of the firm and oversight of risk and compliance

Board Statutes (or Board Charter): Document that details the roles, responsibilities, composition and functioning of the board of directors and its committees.

By-Laws: A written document stating the rules of internal governance for a company as adopted by its board of directors or shareholders. Includes topics such as election of directors, duties of officers, and how share transfers should be conducted.

C

Cash Flow Rights: The right to receive a specified portion of the company's profits. Cash-flow rights for shareholders are determined by the company, based on the amount invested and the ownership of the specific class of shares.

Chairman/Chairperson of the Board: Highest-ranking director in a board of directors. The chairman is responsible for leadership of the board, the effectiveness of the board's functioning, that it has proper access to all the information it requires to make an informed decision, the elaboration of the board agenda, and ensuring that the board's business is conducted in the interest of all shareholders.

Company Charter: An official document filed with the relevant government agency in the country where the firm is incorporated. The charter outlines the corporation's purpose, powers under law, authorized classes of securities to be issued and the rights and liabilities of shareholders and directors.

Chief Executive Officer (CEO): The highest-ranking management officer of the company who reports to the board of directors. The CEO is tasked with short-term decisions and leadership of employees, implementation of strategy, risk management and oversight of management..

Classified Board: Structure of board of directors in which every year, a fraction of the directors are elected, each for a multiyear term. Also called classified board.

Codes of Conduct/Ethics: Developed and adopted by organizations to define appropriate behaviors and actions on relevant and potentially delicate subjects. It is an indicator of how the company will achieve its goals and go about its business.

Committees of the Board: Comprises board members only; committees are established to assist the board in the analysis of specific subjects outside of regular board meetings. Common committees are the Audit, Remuneration and Nomination Committees.

Common Shares: Equity securities representing ownership in a corporation and providing the holders with voting rights and the right to a share in the company's residual earnings through dividends and/or capital appreciation.

Compliance: Agreeing to and abiding by rules and regulations. In general, compliance means conforming to a specification or policy (internal or external), standard or law that has been clearly defined.

Concentrated Ownership: A form of ownership in which a single shareholder (or a small group of shareholders) holds the majority of the company's voting shares.

Conflict of Interest: Reflects both a legal and/or ethical situation where loyalties, interests and duties compete and conflict. It includes a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest. It may also be a situation in which a party's responsibility to a second party limits its ability to discharge its responsibility to a third party. Directors have a duty to avoid conflicts of interest and should always act in the best interests of the company and the shareholders as a whole.

Control Block: The combined group of shares that represent the majority of a company's voting shares.

Controlled Companies: Firms in which an individual or a number of connected individuals or a legal entity holds the majority of the voting rights.

Controlling Shareholders: Shareholders who own enough of the company's voting capital to control the composition of the board of directors — typically, this is 30 percent or more and is usually a controlling family or state shareholder.

Cost of Capital: The expected rate of return the market requires to attract funding for a particular investment.

Cost of Debt: The cost of funds borrowed at current market rates.

Cost of Equity: The minimum rate of return a firm must offer the owners — as compensation for a delay in the return on the investment and for taking on the risk.

Cumulative Voting: A voting system that gives minority shareholders more power, by allowing them to cast all of their board of director votes for a single candidate, as opposed to regular or statutory voting, in which shareholders must vote for a different candidate for each available seat, or distribute their votes between a number of candidates.

Current Ratio (current assets/current liabilities): A measure of the short-term liquidity of the firm — the ability to pay its short-term liabilities.

D

Daily Volume of Shares Traded: Volume of a given share traded on the financial exchange each day.

Debt Ratio (current + long term financial debt / total assets): A measure of the long-term financial leverage of the firm.

Dividend Yield: The ratio of annualized dividends to the price of a share. Dividend yields are used widely to measure the income return of a share.

Disclosure: Refers to the obligation of a firm to provide material, market-influencing information in accordance with the requirements of a number of parties, including regulatory authorities, the public or in accordance with standards, such as accounting standards, and self-regulatory contracts. Disclosure contributes to the transparency of the firm, which is one of the main corporate governance principles.

Dispersed Ownership: An ownership structure in which there is no controlling block of shareholders. The shares are held by many shareholders, each of whom owns only a small percentage of shares, and none of whom can make or influence decisions on corporate matters alone.

Dual-class shares: Shares that have different rights, such as A Class and B Class shares, where one class has voting rights and the other does not.

E

EBITDA Margin (EBITDA / operational revenues): A measure of profitability, indicating the margin of return for a company's Earnings Before Interest, Tax, Depreciation, and Amortization.

Economic Profit (Residual Profit): The profit earned after deductions for the cost of all capital invested. Economic profit equals operating profit after income tax minus cost of capital invested.

Economic Value Added (EVA): A financial measure that estimates the true economic profit after adjustments/corrections to deduct the opportunity cost of equity capital. The measure represents the value created, above the required return, for the company's shareholders.

Executive Session: The portion of a board of directors' meeting that excludes the chief executive or any other executive.

F

Family Constitution: Guidelines for the rights and duties of family members who will share in the family's resources, mainly those associated with invested companies.

Family Council: Organized forum for family members to meet and discuss the current and future state of the family business. Members may, or may not, be directly involved in the day-to-day business operations. The family council is a way of building family unity and cohesiveness through a shared vision of the family's guiding principles and to separate the professional management of the firm from the personal family issues. It is usually the forum to determine how the family shareholding will be voted on any matter.

Family Office: A group of support services designed for families with very large and complex sets of assets. Often they will comprise financial, legal and investment banking support. The office is intended to protect family interests. The Family Office is intended as a vehicle for optimal management and comprehensive coordination of individual wealth components. The family office can be a tool to implement broader succession, leadership, and family governance plans.

Family-Owned Businesses: Companies and projects in which the controlling shareholders belong to the same family (immediate or wider family members) or group of families.

Fairness: Respect for the rights of all shareholders and stakeholders. One of the corporate governance principles ensuring the equal treatment of all shareholders and attention to the legitimate rights of stakeholders.

Financial Statements: a complete set of financial statements comprises a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and notes. They collectively communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework.

Free-Float: The portion of shares negotiated in the market, giving liquidity to shares. These shares are not held by large owners and are not shares held in the company's treasury.

FSA: Financial Services Authority in the United Kingdom, responsible for market regulation and oversight.

G

Generally Accepted Accounting Principles (GAAP): Accounting rules, conventions and standards for companies, established by reporting requirements and accounting standard setters in the country. Each country is likely to have a GAAP, which is unlikely to be identical to any other country's GAAP. For example US GAAP is the body of accounting policies applicable to U.S.-registered firms and the GAAP rules are issued by the Financial Accounting Standards Board (FASB). These are not identical to IFRS standards issued by the International Accounting Standards Board and applied in Europe and many other countries.

H

Hostile Takeover: The continued pursuit of a company acquisition after the target company's board rejects the offer; or a situation, in which the bidder makes an offer without prior notification of the target company's board.

I

Independent Auditors: Professionals from an external audit firm charged with undertaking an audit of the financial statements. An audit may be required annually, half-yearly or quarterly. In most countries the independent auditors undertake an annual audit. They must have no personal interest in the financial statements and ought not to have had any role in the development of the financial statements. The independent auditor is required to render an unbiased judgment that the financial statements and accounting records of the firm are likely to be free from material misstatement and are a fair reflection of the financial position of the firm.

Independent Director: Someone whose only nontrivial professional, familial, personal or financial connection to the corporation, its chairman, CEO or any other executive officer is his or her directorship. The independent director is expected to be capable of applying objective judgment to all company decisions.

Insider trading: Trading in securities by someone connected with the company or with special knowledge about the company. Insider trading can be illegal or legal, depending on when the insider makes the trade. It is illegal when the material information is not available to the public and such information has the capacity to have an effect on the share price.

Institutional investors: Are professional investors who act on behalf of beneficiaries, such as individual savers or pension fund members. Institutional investors/shareholders may be the collective investment vehicles, which pool the savings of many or the asset managers to whom they allocate the funds. (Definition taken from ICGN – Corporate Risk Oversight Guidelines 2010).

Internal Audit: An independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Investor Relations: The corporate communications department of a company. This department specializes in information and disclosure management for public and private companies as they communicate with the investment community at large.

L

Lead Director: A term used in the United States to refer to an independent director who should provide counterbalance to the power of any controlling shareholders' representatives on the board and/or the CEO. The Lead Director tends to be the leader of several independent directors on the board and who ensures that the supervisory responsibilities of the board are being accomplished. The Lead Director's core responsibilities include involvement in agenda setting, chairing executive sessions, providing feedback to the CEO after executive sessions and helping to shape boardroom dynamics.

Liquidity Index: Created by stock markets to provide a broad indica-

tion of the traded percentage of volume for a given stock over the total volume traded by all stocks in the period.

M

Market Capitalization: The market value of the firm, defined by the number of outstanding stock multiplied by the market price of the stock.

Minority Shareholders: Those shareholders with minority stakes in a company controlled by a majority shareholder — usually less than a 5 percent stake. However, each country may determine various thresholds applicable to the term "minority shareholder."

N

Non-Voting Shares: Owners holding this share class do not commonly have voting rights at the AGM, except on some matters of highest importance. Usually, non-voting shareowners have preferential rights for receiving dividends.

O

One-tier board: A board of directors composed of both executive and non-executive members. It delegates day-to-day business to the management team. Found in U.S., the U.K., Commonwealth countries. (see Two-tier Board)

Ownership Structure: The way in which company shares are distributed among shareholders.

P

Payout Index (dividend per share / earnings per share): A measure of the dividends paid by the firm based on its net earnings.

Price/Earnings (PE) Ratio: A measure of relative valuation of a firm, determined by the current share price divided by the projected earnings per share.

Present Book Value (PBV): A measure of relative valuation of a firm, given by the current share price divided by the book value of shares.

Poison Pill: A device designed to prevent a hostile takeover by increasing the takeover cost, usually through the issuance of new preferred shares that carry severe redemption provisions or other mechanisms that invoke special bonus exit provisions for senior executives of the takeover target.

Preferred Shares: Equity securities representing ownership in a corporation with preferential rights over other share classes in regard to the payment of dividends and distribution of assets upon liquidation. Preferred shares usually do not carry voting rights.

Proxy: A proxy in CG terms is an person or agent, legally authorized to act on behalf of another party. Very often, shareowners not attending a company's annual meeting, may choose to vote their shares on resolutions being put to the meeting by proxy. The proxy will cast votes on relevant issues on the shareowners' behalf. Most companies, when they circulate notices for the annual meeting to shareowners, include a proxy notice. This is a notice providing information on the issues on which there will be a vote at the meeting. The proxy information should allow shareowners to make an informed decision on the issue.

Pulverized/Dispersed Ownership: An ownership structure in which there are no controlling shareholders.

Pyramidal Structure: An organizational structure common in family-dominated companies. Legally independent companies are controlled by the same family through a chain of ownership relations.

R

Related Party: A party is related to an entity if it can directly or indirectly control the other party or exercise control through other parties; it may also be where parties are subject to a common control from the same source. Related parties tend to have influence over the financial or operating policies of a firm or have the power to influence another party's actions. A related party may be a close family member (including partners, spouses, children, other relatives), a key manager in the entity (and their close family members), or entities, such as subsidiaries of the entity, it holding company, joint ventures, and associates.

Return on Equity (ROE): Net income/book value of equity. A measure of profitability, indicating the percentage return on capital invested by shareholders.

Risk Management: The process of identifying, analyzing, managing and monitoring a corporation's exposure to risk and determining optimal approaches to handling such exposure.

S

Sarbanes-Oxley Act: U.S. legislation that tightened up corporate financial reporting, introduced a federal accounting supervision board and criminal liability for executives who are shown to have falsified accounts.

Say on Pay: The ability of shareholders in a corporation to actively vote on how much senior executives employed by the company should be compensated. Corporate laws may provide this power to shareholders.

Securities and Exchange Commission (SEC): The U.S. agency empowered to regulate U.S. financial markets to protect investors. All companies listed in U.S. stock exchanges must comply with SEC rules and regulations.

Shareholders: Holders of shares issued by companies.

Shareholders' Agreement: A written document governing the relations among shareholders and defining how the company will be managed and controlled. The agreement helps to align the objectives of controlling shareholders to safeguard common interests and to protect the interests of minority shareholders.

Shareholders Rights: The rights resulting from ownership of shares, which may be based in legal rights or other rights contracted with the company. The basic shareholder rights include the right to information on the company, to attend the meeting of shareholders, to elect directors, to appoint the external auditor, voting rights and cash flow rights.

Standard & Poor's 500 Index (S&P500): An index of the 500 largest U.S. companies, accounting for 85 percent of the dollar value of all shares listed on the New York Stock Exchange (NYSE). The index provides a general measure of the overall performance of the U.S. stock market.

Solvency Ratio (EBIT/Interest Expense): A measure of a firm's ability to pay its interest expenses in a given period.

Staggered Board: Structure of board of directors in which every year a fraction of the directors are elected, each for a multiyear term. Also called a classified board.

Stakeholder: A person or organization with a legitimate interest in a project or company. In a more general sense, it refers to suppliers, creditors, clients, employees, and the local community — all affected by the actions of the company.

Share Multiple (Share Ratios): Ratios designed to measure the claims of shareholders relative to earnings (cash flow per share) and equity (book value per share) of a firm.

Share Option: An agreement, or privilege, which conveys the right to buy or sell a specific security or property at a specified price, by a specific date. The most common share options are: calls — the right to buy a specified quantity of a security at a set strike price at a time on or before expiration — and puts — the right to sell a specified quantity of a security at a set strike price at a time on or before expiration.

T

Tag-Along Rights: If a majority shareholder sells his/her stake, minority holders have the right to participate and sell their stake under the same terms and conditions as the majority shareholder. This right protects minority shareholders and is a standard inclusion in shareholders' agreements.

Takeover: The purchase of a public company (the target) by another company (the acquirer or bidder).

Tobins' Q: A proxy for corporate market value commonly used in academic literature. It is calculated as the market value of a firm's assets divided by the replacement value of the firm's assets. The indicator is named for James Tobin, the Yale University Nobel-winning economist who created it.

Trading Policy: Terms and conditions that specify the conditions under which insiders — typically directors and officers of a company — can trade company shares. It also includes specific periods when insiders may not trade their shares, called "black out periods."

Transparency: The corporate governance principle of publishing and disclosing information relevant to stakeholders' interests and to shareholders on all price-sensitive material matters

Tunneling: An illegal business practice in which a majority shareholder or a high-level company insider directs company assets or future business to themselves for personal gain.

Two-tier Board: A board of directors that divides supervisory and management duties into two separate bodies. The supervisory board, comprising non-executive directors, oversees the management board, comprising executive directors. Common in France, Germany, Eastern Europe. Not all styles of two-tier board are identical.

V

Value Based Management (VBM): Value Based Management (VBM) is the management approach that ensures corporations are managed consistently on value (normally maximizing shareholder value). The three elements of VBM are: creating value — how the company can increase or generate maximize future value, similar to strategy; managing for value — governance, change management, organizational culture, communication and leadership; and measuring value — valuation.

Voting Rights: The right to vote at shareholders' meetings on issues of importance for the company.

Voting Shares: Shares that give the shareholder the right to vote on matters of corporate policy, including elections to the board of directors.

W

Weighted Average Cost of Capital (WACC): A measure of return on a potential investment. The measure includes cost of debt and equity, weighted by their relative contribution to overall costs in proportion to total funding and the cost of the related interest or dividend payments

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 IFC, co-founded in 1999 by the World Bank and the Organisation for Economic Co-operation and Development (OECD).

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