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NEW IDEAS AND BEST PRACTICES IN MARKETING COMMUNICATIONS

# The New World of Corporate Governance

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**If you're a communications professional who hasn't given much thought to corporate governance issues, it's time to learn. In the wake of high-profile scandals, stakeholders are more informed than ever about the way companies manage themselves. Kurt Stocker argues for why communicators must deal with corporate governance issues now, as neglecting new rules and new attitudes can ruin a corporation's credibility.**

The latest communications challenge for Corporate America stems from the changing world of corporate governance. Rarely discussed in the past, governance issues were propelled to the front page by Enron, and with a major push from Arthur Andersen, scandals involving governance have since plagued some of the best brand names in the world. What started as an isolated failure of board oversight mixed with corporate greed has rapidly bred new rules, new penalties, shifts of power, and in the meantime turned the corporate credibility paradigm on its end. We see the daily parade of governance failures listed on the front page of *The Wall Street Journal*, but to underscore the importance and broad nature of this newest crisis, these stories also appear on the front pages of local newspapers across the country.

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Professionals who have been in a public corporation for more than a few years have either participated in the quarterly conversations around the need to meet Wall Street's earnings estimates, or heard their CEO complain about the short view of business it mandates. It was the need to constantly increase the stock price and support over-the-top incentive systems that drove some companies to violate the trust of their shareholders and employees. The problem was simple. As long as stock prices grew, escalating executive salaries, golden parachutes and separation deals that would normally cause angst among shareholders were set aside as investors were quieted by the bubble in their portfolios. The extravagant incentives that were "tying management to the shareholder" seemed to be working—everyone won. Investors started to pay attention when corporate earnings cratered and portfolios collapsed, but executive compensation continued to go in the opposite direction.

## Corporate Credibility Is at an All-Time Low

The real conundrum is what came first: the new rules and regulations, formulated by the NYSE, Inc. (New York Stock Exchange) and the U.S. Securities and Exchange Commission (SEC) initiated as a result of governance abuses? Or was it the unintended corporate transparency driven by increased public access to information? Credibility of corporations, regulators, and the traditional deliverers of information—the media—are at all time lows. This phenomenon is exacerbated by a public that is now paying attention because they feel they have been lied to by the companies they invest in, the brokerages that they trusted to be independent and the media that should have had a better understanding of business and warned them about the problems.

Conference Board editor A. J. Yogt wrote that, "People think corporations have too much power and will do anything in pursuit of profits…and now add to that public distrust…a flagging economy, a shambolic stock market and what some have termed 'pornographic' CEO salaries." Pressure is being exerted by the public and the individual investor, either directly or through the institutions that hold their investments. In a recent survey of large companies, top management reported that the pressure to become more transparent was coming from outside the company, with only 7 percent reporting it was instigated by members of their own company. This demonstrates a real failure to understand the crucial and timely nature of real corporate governance reform and more effective communication of reform to stakeholders.

## nvironmental Shifts in the Market

There are three major environmental shifts that are causing increased awareness and activism among shareholders. First, we have moved from a communications model to a behavioral model, not out of choice or lack of talent but because organizations can no longer "manage" communications. Historically, when faced with issues or crisis, companies would "talk their way out of it." They would modify how they communicated rather than what actions they took as a result of their failing. The late, great Arthur Anderson and the Archdiocese of Boston gave us the perfect examples when they refused to focus on their own governance, instead adopting the posture of the victim, which by definition abandoned any responsibility to change their behavior. There was a day when communicating around an issue was the right tactic but as the public acquired more access to real-time information about what actions the company was taking, the paradigm changed. There are no secrets, anywhere, or at any time. If it happened, if you said it, or if you wrote it, it will come out and be made public. The electronic memory of the Internet, corporate intranets and email has helped make what was once proprietary information available to a broad audience of stakeholders. This audience that can compare and judge what is happening for them. This is an audience that can now monitor the actions of an organization or individual, an audience supplied with information from employees or regulators who are quick to identify wrong deeds and wrong doers.

A survey of employees last year, before the worst of this, indicated that more than half of all employees would make public actions that they felt were wrong. We are dealing with the best-informed customers and investors we have ever seen and they are acting on that information. They are acting individually, not carrying signs or marching, but voting with their feet and with their portfolios. Before any legal penalties might be incurred, the public takes it into their own hands to punish those they feel have done them wrong. Look at the $43 million loss in net worth that Martha Stewart paid for her behavior or the loss in record sales faced by the Dixie Chicks after coming out against the war and the administration.

The public is watching and evaluating our behavior and then acting independent of all the advice and "spin" they receive from the company or the media. In the current proxy season the number of shareholder proposals is up more than 30 percent and most of those dealing with executive compensation and retirement plans are being passed by large margins.

And third, the research supports what we already know. Companies are accused of trying to put their results in the best light regardless of the actual outcomes. Individual investors believe that reporters don't really understand business or the companies they are writing about, and then add personal bias. Others contend that analysts have skewed their research and opinions as unintended consequences of lucrative incentive programs. With all these factors at play, there isn't much left on the table with which a communications executive can rebuild corporate reputation.

## Governance is Not Compliance

There was a time when the only information the public

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received is what corporate communications departments gave them, but that time has passed and now they see everything we do when the door is closed. The public is very clear on standards of behavior, especially when things go bad. Just meeting the letter of the law or regulation will not necessarily satisfy shareholders, employees or communities. They are concerned with what integrated communications models call outcome, not output. In financial communications there are many new regulations concerning how to explain corporate results and corporate potential and they help to eliminate organizations' ability to mislead the public about their financial heath and prospects.

But we have a big problem: the loss of credibility of our traditional interpreters and deliverers of corporate information. Our entire delivery system for financial information has been trashed. The mandated press release that was the basis of media reports is no longer a dependable vehicle to reach our customers, investors or employees. They feel that reporters really don't understand what they are reporting on and, in addition, seem to have a bias.

A skeptical public wants more that just an increase in the amount of information, as dictated by federal regulators; they want the ability to understand it. This is the job of the corporate ommunicator, or at least it should be. The twin problems of pro-ucing corporate information that accurately portrays the status f the company and then finding more credible ways to deliver his information to the public should be job insurance for some ime.

## he New Rules are Directional

The new rules for governance were initiated last year by the NYSE, requiring compliance among companies listed on their xchange. This was followed rapidly by Congress and the arbanes-Oxley Act and finally added to and made law by the EC. Everyone wanted to get into the act. These new rules were imed at two public concerns: first, more independence of the oard and its committees and second, more timely and under-tandable information to shareholders.

The new rules are far-reaching and, while many companies ave little to change, others will need to make wholesale changes n their boards and their investor relations. Boards will now have majority of independent directors that are not influenced by elationships, employment, family or the need for the director's ompensation. The major committees must be made up exclu-ively by independent directors who will have more power and nore responsibility for financial reporting, employment of out-ide auditors and executive compensation and succession. Companies and boards must now publish policies, committee harters and evaluations. The penalties for violating the rules have een increased to the point that we are now seeing smaller fish unning to the authorities to cut a deal. By mid-year, the SEC ad already sanctioned 144 individual executives by barring them rom serving as an elected official or board member of a public orporation for the rest of their lives.

## arketing Your Governance

To complicate the process, a variety of rating firms have prung up to attempt to evaluate each corporation's governance. These firms attempt, in a variety of ways, to rate the governance f individual corporations, and in some cases sell consulting serv-ces to improve the rating. It is a scramble for the high ground or corporations that want the support of their investors and the redicted premium that will be paid for good governance. ncreased stock price is the goal. This might be the biggest pay-ff, and one that should drive a truly integrated marketing com-nunication program.

It should be a given that each corporation will comply with he new rules and many will exceed them in an effort to stand bove the others. But will these actions be understood by stake-holders? It appears that most of the least sophisticated investors will not understand the changes as they are mostly invisible to them and therefore meaningless. Institutional investors, on the other end of the scale, will be watching how companies are governed, generally ignoring all the new policies and programs driven by this process. It's back to behavior.

And how do we market this new governance—the independence of our directors, the credibility of our financial results and the appropriateness of executive compensation? It can only be accomplished through integration at the source of the problem. Communications departments will have to plan centrally with the investor relations and marketing communications staff.

Credibility will be improved over time by consistent and understandable reporting of results. It can be enhanced by third parties—the media and Wall Street experts—but among some audiences their credibility is worse than ours right now. Reputation can be improved by exceeding the requirements of federal regulation, but much of the competition will be doing the same. Clearly all these tactics are necessary if we want to avoid distracting shareholder proposals and proxy votes.

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To summarize, management and boards of directors need to do the "right thing," not just the legal requirement or the most conservative approach. The public can recognize and reward us when they see us making decisions in their best interest, not ours. Independent directors must be truly independent in the eyes of our shareholders, without exceptions or need for explanation.

We must then strive for understanding of company plans and results. This can be accomplished through tracking investor understanding, finding the gaps between what we think we conveyed and what stakeholders heard and then addressing any discrepancies. Simple testing or even pre-testing of communications efforts will be necessary. We must take the responsibility for message development away from the accountants and the lawyers. Let them vet the information, but let communicators craft the reports—it is now all about understanding.

The channel through which we reach the public may just as important that what we communicate. Traditional press releases will no doubt continue, but these must be supplemented with alternate communications channels. The first place to look will be the same place our investors, rating agencies and press look:

:orporate web sites. Marketing communications must do much nore than market products—it should market how the company s run and who is running it. We need to restore confidence in nanagement, executive compensation and the independence of our individual directors. We need to engage shareholders and rally their support for these efforts because they will now be able to vote even if their stock is held by a brokerage.

The answers seem simple when we look at the ongoing effort of marketing our company's governance in those terms—as marketing efforts. It will require organizational integration, centralized planning and highly consistent execution. That will not be easy, but the payoffs are enormous, measurable and right down our professional alley.

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