THE BUSINESS VALUE OF GOOD CORPORATE GOVERNANCE

Companies that take a strategic approach to the challenge of complying with tough new corporate governance requirements can create opportunities to strengthen their internal processes and enhance their business.

This article is one in a series from the Microsoft Office System that explores issues and perspectives facing finance executives.

Making Sense of the Global Regulatory Patchwork

For the global economic system to function as it should, investors, employees, consumers, and the general public must have confidence that they will benefit from it—and from the work of corporations that support it. Recently, that confidence has been severely shaken.

As the names of several top corporations have become synonymous with corporate misconduct and financial scandal, a call for more effective corporate governance has been raised worldwide—from financial reporting and internal controls to how a corporation selects, trains, and evaluates its board of directors. This article is not a legal analysis of corporate governance, but rather a look at a range of issues associated with it and how some companies are responding to those issues and using compliance efforts to build greater business value.

Although corporate governance has largely been portrayed as an issue of compliance, analysts and business leaders increasingly are seeing good governance as good business. Finance organizations will see the cost of compliance increase in the coming years as firms move from the investigational phase to implementation. Hence, finance executives are looking carefully at the cost-benefit of compliance. In the end, sound corporate governance can reduce market volatility, encourage investment and promote sustainable productivity and growth. The push today is toward putting into place a combination of internal controls, explicit businesses processes and systems for corporate governance that can also build business value.

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One of the most sweeping recent attempts to enact corporate governance reform is the Sarbanes-Oxley Act, passed by the U.S. Congress and signed into law on July 30, 2002. Sarbanes-Oxley, the most far-reaching United States legislation dealing with securities since the 1930s, has extraordinary implications for public
companies in terms of legal liability and public perception. As a result, the need for stronger corporate governance, better internal controls, and increased financial transparency are now major topics of discussion from the executive board room to the employee water cooler.

And governance reform is far from just an issue in the United States. Governments and regulatory bodies from the European Union to the Pacific Rim have issued strict new laws and regulations intended to increase corporate accountability and guide many aspects of corporate behavior. The European Commission recently launched two important new European Union policies—one on corporate governance and the other on audit reform. Simultaneously, member nations, for example Ireland, have created their own legislation. New governance regulations set by the Basel Committee on Banking Supervision, which have implications for Europe in addition to the Asia-Pacific region, are now creating additional complexity and uncertainty for organizations in the capital markets that must comply with them. This flurry of activity prompted the Irish Times to write that, “the year 2003 should be one of audit reform in Europe.”

The issue at hand is not simply one of avoiding the costs of government regulation and compliance. A company’s integrity, and the level of public trust it enjoys, can have a dramatic effect on core business issue—from the flow of investment capital, to consumer buying decisions, to the company’s ability to attract and retain the most talented employees. According to Raja Arshad, executive chairman of PricewaterhouseCoopers (PwC), a global accounting firm, institutional investors have indicated their willingness to pay a premium of 10 to 50 percent for companies with excellent corporate governance practices.

Small wonder, then, that many corporations are scrambling to institute visible changes in the way they govern themselves.

**The Business of Compliance**

The rise of corporate governance as a business priority has created a growing industry of experts peddling advice. The analysis and counsel runs the gamut from how to put business processes into place to the board’s new role to understanding the increasingly complex international patchwork of rules, policies and guidelines related to corporate governance.

In racing to understand and comply with the new regulations, many companies have complained that they lack the time necessary to develop a cohesive strategy to ensure their compliance efforts will also benefit their business in other ways. Recently, they got some good news when they were notified that compliance with section 404 of Sarbanes-Oxley was delayed until June, 2004. This spurred many CFOs and CIOs in particular to take advantage of the delay and use the additional time to partner more closely in building business value within the context of compliance. According to Optimize, a publication for CIOs, true business value can be created during this phase by strengthening finance, accounting, and performance-management processes.

Analysts at AMR Research, an independent research analyst firm that works with many of the world’s leading corporations, point out that smart companies’ reactions to the current wave of corporate governance reform is analogous to reactions to the year 2000: “Some put the bulk of their process and control documentation efforts on key accounts or areas of the balance sheet, such as cash, accounts receivable, or accounts payable.”
Compliance as Strategy

In its own drive toward compliance, Microsoft has focused on 5 broad technology areas that also will enhance companywide productivity and collaboration:

**DOCUMENT MANAGEMENT**
How do we provide unstructured information management?

**RECORDS MANAGEMENT**
What are the rules surrounding security and retention?

**KNOWLEDGE MANAGEMENT**
How do we enhance workflow, collaboration and application integration?

**AUTHENTICATION AND SECURITY**
What is the appropriate underlying security and integrity infrastructure?

**ANALYTICS**
How do we incorporate business intelligence, data warehousing and executive reporting into the program?

Others take a process-centered approach concentrated on their firms’ major business processes, including finance and business operations.” There is no single approach that works for all companies.

In its recent survey of executives implementing Basel compliance programs, however, KPMG, a global accounting firm, found that participants highlighted the importance of several key elements for success: clarity of scope, management of stakeholder expectations, project transparency, and regular reporting.

More broadly, efforts to reform corporate governance often focus on changing the composition and structure of a company’s board of directors, such as requiring a certain percentage of directors to be recruited from outside the company, appointing a lead director separate from the corporation chairman, and requiring members of board audit and nominating committees to be outsiders. In the profile of Delphi that follows, you also see how re-imagining the role of the board can strengthen corporate governance, build business value, and encourage collaboration from top to bottom.

In the wake of Sarbanes-Oxley and other major reforms, the world is re-awakening to the need for common global corporate governance standards.

Roger Davis, a partner with PwC, makes the case for common principles within corporate governance as not only a means of ensuring compliance but also building business value. “The wider importance of the European proposals relates to the need for global standards of corporate governance, accountability, auditing, and capital market regulation. The fact that aftershocks of the corporate scandals in the United States reverberated around the world is not surprising, given the importance of the U.S. market. But the panic reaction in many countries showed just how interdependent are the world’s capital markets; yet the world lacks any mutually agreed principles for their regulation.”

Felipe Gonzalez, former prime minister of Spain, made a similar point at an international conference hosted by Korea and the World Bank in 2001. “National capital markets are no longer isolated. Developing countries must be able to meet fiscal reporting standards of developed countries in order to secure their place in the world economy.”

Many experts believe that governance begins at home—inside the boardroom, among the directors. Good governance is woven into how, when, and why directors work together and interact with management and the rest of the organization. Increasingly, many analysts are advocating approaches that combine “soft” qualitative reforms— which address the behavior, relationships, and objectives of the directors and the CEO— with “hard” quantitative mechanisms, such as performance criteria, processes, and measurements.

According to Booz Allen and Hamilton, a global business strategy consultancy, this combination of soft and hard solutions can turn governance from a vague concept into a means to deliver organizational resilience, robustness, and continuously improved corporate performance.

Reinventing Corporate Governance at Delphi

In the summer 2003 issue of Booz Allen and Hamilton’s publication, Strategy + Business, Andrea Gabor writes about how Delphi Corporation, the world’s largest automotive supply company, reinvented corporate governance with a unique effort to make the firm’s board of directors
serve more as a resource than simply an oversight body. “The 12 directors—nine of whom are outsiders—have a rich body of industry-specific knowledge to support the company’s key strategies.”

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In making that governance choice, a company is really making a bet that increased collaboration between the board and key managers will increase productivity across the entire organization and drive growth and profitability. More transparent management processes and an open communications structure shorten the time to business insight for both directors and managers, enabling timely and effective decision making and optimizing cross-group collaboration. The difficulty becomes creating the proper tools and business processes that enable and encourage greater interaction—deeper collaboration from top to bottom.

As an executive vice president at General Motors in the early 1990s, J.T. Battenberg III learned some hard lessons as the automaker ousted its CEO and weathered a crisis in corporate governance. When Battenberg became CEO of the Delphi Corporation, he applied those lessons to create what Jay Lorsch, a corporate governance expert at the Harvard Business School, calls one of the most effective and unusual boards in the United States.

By design, Delphi’s board is positioned not only to advise, but also to be fully engaged in company strategy. Individual board members are chosen for skills that will be useful to the company — many are considered leading industry experts — and for their ability to help Delphi overcome its strategic and managerial challenges. Delphi’s governance structure is designed to facilitate directors’ exposure to employees and company processes, and to make maximum use of their skills.

According to Professor Jay Lorsch, most boards find it hard to truly help shape company strategy, which he defines as the goals a company will pursue and how it will pursue them. At Delphi, things are different.

“The board at Delphi is engaged in a constant dialogue” with key leaders throughout the organization, says Lorsch. For companies who may follow suit, that dialogue can be enhanced through tools and solutions that promote effective leadership and stronger business alignment within the organization, leading to both increased corporate accountability and enhanced shareholder value.

**Our Assessment:**
**Build Capacity Now**

Although few corporations ever experience the kind of problems that have inspired tougher rules for corporate governance, all must comply with the new requirements. At times, companies might feel as though they are paying unfairly for others’ mistakes, but compliance does not have to be all burden and no benefit.

Even Sarbanes-Oxley, with its extensive reforms, can be a boon to corporations that take a strategic approach to the challenge of compliance. For example, Section 404 of the new law requires companies to rigorously maintain and monitor their internal controls. Although setting up or improving those systems and processes can create short-term expense and frustration, it can also help some companies enhance their internal control mechanisms for long-
term productivity and substantial financial gains. See “The Business of Compliance” on page 2.

According to an online survey conducted by AMR Research, Fortune 1000 companies have earmarked $2.5 billion in 2003 for work related to investigation of and initial compliance with Sarbanes-Oxley. Eighty-five percent of those companies predicted that complying with the new law would require changes in IT infrastructure, and 61 percent expected to upgrade their internal controls, automate records management and reporting, and overhaul their business processes to improve risk assessment and financial visibility. Deloitte and Touche estimates the average Fortune 500 corporation will spend $3 to $5 million annually to redesign their internal controls.

Viewed as an opportunity, however, Sarbanes-Oxley compliance could be a compelling event to inspire specific system and process improvements. The investments corporations often must make to ensure their compliance with new laws aimed at strengthening corporate governance can also help them create better business processes, increase employee satisfaction, boost investor confidence, and deepen management’s understanding of the business.

Debra Logan of Gartner Research sums it up: “Most enterprises should take a step further than ‘just complying’ with Sarbanes-Oxley. If you must keep certain records for the purposes of Sarbanes-Oxley, don’t stop there. Most enterprises have huge content management problems, uncontrolled explosions of e-mail and lack of policy and procedure around many document based processes. Take advantage of this forced opportunity to roll out document and records management software and procedures to gain business efficiency as well, rather than just using it to reduce the risk of noncompliance.”

As Logan suggests, compliance discussions may ultimately drive key infrastructure decisions as companies strive to enable better decisions by improving business processes and strengthening internal controls. To meet the rigorous new reporting requirements, such as real-time reporting of material information, companies must have systems that can talk to each other, share data easily, and increase information visibility at every level of the organization.

In working to ensure compliance with Sarbanes-Oxley and other corporate governance laws, regulations and policies worldwide, companies should focus on building business processes and infrastructures that not only ensure compliance but also increase their company’s capacity for efficiency, agility, and responsive management.

The Microsoft Office System Can Help

Identifying the right business applications to meet your organization’s needs sometimes can be overwhelming. Microsoft is experienced in helping companies address their critical business needs such as cutting costs while simultaneously planning for growth and innovation. The Microsoft Office System is a reliable business platform that allows you to manage business insight, adapt processes to address ever-changing customer needs, and leverage your organization’s strategic assets while improving productivity, visibility, and integrity.

Additional Resources

Microsoft Office System
www.microsoft.com/office

Corporate Governance
www.corpgov.net

The Corporate Library
www.thecorporatelibrary.com

The U.S. Security and Exchange Commission
www.sec.gov

Boardroom Insider
www.boardroominsider.com

Business Roundtable
www.brtable.org

European Corporate Governance Institute
www.ecgi.org

Strategy + Business
www.strategy-business.com