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REPORT

# COMPLIANCE AND CLARITY: COMMUNICATIONS AND CORPORATE GOVERNANCE

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## INTRODUCTION

Professors Andrei Shlifer and Robert W. Vishny from (respectively) Harvard University and Chicago Booth School define corporate governance as "the form and means through which those who provide financial funds ensure the right return on their investment."

However, Deloitte goes beyond the financial, though it continues to focus on value creation: "Corporate governance is the set of standards, principles and procedures that rule the structure and operation of a company's governing bodies. Specifically, it defines the relationship between its board of directors, managing board, shareholders and other stakeholders, setting forth the regulations that will govern the decision-making process in the company to generate value."

**"Transparency is no longer a strategy or an option, it has become an unavoidable condition"**

The Organization for Economic Cooperation and Development (OECD) and group of countries that make up the G20 include two additional concepts: longevity and integrity. In their definition, they state that "the goal of corporate governance is to facilitate the creation of an environment of trust, transparency and accountability, which is necessary for long-term investment, financial stability and business integrity."

The OECD involves companies in the generation of this "environment of trust," which facilitates economic growth. One of the key principles when working to generate trust is transparency. Paradigm changes regarding information ownership, which has been largely disentailed and is now faced with a lack of control (and all associated effects), has led to a new scenario for companies, one in which transparency is no longer a strategy or an option—it has become an unavoidable condition.

We live in an era of hyper-transparency, a key feature of a time in which "there is no way to escape, no place you can hide," as stated by Andrea Bonime-Blanc, founder of the company GEC Risk Advisory. Organizations must accept that they cannot hide or remain silent, and especially not be passive objects of conversation.

## CONTROL OF POWER

A company's corporate governance encompasses the following areas:

- The decision-making process related to the company's **general strategic direction and corporate policies**, including investments, mergers & acquisitions, executive appointments and succession planning.
- The mechanisms that guarantee executive management's **proper performance** and approved **strategic plan's implementation**.
- The establishment of **appropriate policies and procedures** to ensure the company and its managers, as well as its employees and involved third parties, comply with the relevant regulatory framework.
- The **communication channels** between the company's main governing bodies, as well as the execution of their rights and duties, including the management board, board of directors and shareholders.

The common denominator in the various roles in corporate governance is control of decision-making power. "Power is the ability to influence people to act in a certain way," say White and Bednar, authors of the book *Organizational Behavior: Understanding and Managing People at Work*. Control appears in all corporate governance models but, in order to control, you must first know. This is the reasoning behind the connection between transparency and reporting.

## FROM FINANCIAL TO INTEGRATED REPORT

One of the keys to good corporate governance is keeping stakeholders informed of all events that may impact the operation and, above all, the progression of the results.

This obligation to be transparent is mentioned in general terms in communication policies, frequently appearing in regular reports and, specifically, road shows.

The most common types of reports are:

- **Management reports**, which include the annual income statement. These are usually part of annual reports, which contain more information about the different areas of the company.
- **Corporate governance reports**, especially the chapter detailing the remuneration of directors and top executives, which is already mandatory in some countries.
- **Sustainability or corporate social responsibility reports**, which, while not mandatory, companies experience great pressure from various regulatory bodies and society at large to publish annually.

The International Integrated Reporting Council (IIRC) is a global coalition of the regulators, investors, businesses, standard makers, accountants and NGOs who promotes an evolution in corporate reports based on a new way of communicating. The IIRC's vision is to align capital allocation and corporate behavior with broader goals of financial stability and sustainable development through a cycle of integrated reporting and thinking.

The introduction of the integrated report would facilitate business control. It focuses on specific goals, the strategies that will be developed to achieve them and the risks that may arise on the road toward this objective. It is essential that communication departments insist on the adoption of integrated reports and overcome resistance from financial departments; this business area is often reluctant to declare economic goals, especially in today's world, which is characterized by uncertainty and fast change.

In fact, the integrated report specifically considers the management of intangible assets, as they account for 52 percent of the overall enterprise

value of all publicly traded companies worldwide, according to Brand Finance's Global Intangible Finance Tracker (GIFT™). However, the study also reveals that 76 percent of global intangible assets are not accounted for in balance sheets. The value of these undisclosed intangibles increases by 25 percent each year, a growth five times faster than that of disclosed tangible assets (5 percent) or global company value (18 percent).

## FROM REPORTING TO DIALOGUE

Communications can be approached as a tool or as a function. When used as a tool, it is not included in the formulation of the organization's strategy; it simply exists to facilitate. Fortunately for many companies, communications is an explicit part of their strategic planning, which in turn is the main task of the management board.

One of the most important intangible assets a company can possess, communications often becomes more highly valued when a company is facing an issue that could damage its reputation, and is often increased in response to such circumstances.

The governance of an organization requires constant communications in many, if not all, of its areas. In some cases, it is a matter of reporting both financial and nonfinancial results. Here, it is important to note that 'nonfinancial results' is an unfortunate expression used to avoid referring to all other results, especially those that have to do with environmental or social impacts. The expression itself shows how environmental and social impact are often considered secondary to the figures that track a company's fiscal performance.

Several decades ago, companies began to experience social pressure to increase their reporting of nonfinancial results and explain the effects of their work on the environment. This pressure has recently been strengthened by some of the world's largest capital funds, which consider Environmental, Social and Governance (ESG) factors to be additional criteria for making investment decisions.

Among them is BlackRock, the biggest asset manager on the planet, whose CEO, Larry Fink, told the Financial Times last October that "sustainable investment will be a core component of how everyone invests in the future." However, in his opinion, "we are only in the early stages," and assets in exchange-traded funds (ETFs) that incorporate ESG factors will grow from $25 billion to $400 billion in a decade.

**"The value of these undisclosed intangibles increases by 25 percent each year"**

In addition to reporting, communication is essential to keeping decision-making bodies connected with stakeholders. Companies must listen to all those involved in an orderly way, which first requires a willingness to engage in dialogue.

Information technologies have been making these conversations increasingly personal and individual, so the concept of a "stakeholder" has become obsolete due to its inaccuracy.

Assuming all employees think about or relate to the company in the same way is a gross error. Thinking and acting as if all customers want to have the same type of relationship with the brand is as well. Today's communication tends are more individual than collective, though collective communication still influences conversations—particularly through social media, where it can still affect individuals.

## EITHER COMPLY OR EXPLAIN

The main tenet of the Spanish National Securities Market Commission's (CNMV's) Code of Good Governance, which is based on reference documents in the field of corporate governance, is that a company must "either comply or explain." Compliance must not only be to regulations, but also to the rules dictating good practices, which the regulatory

agency understands must be incorporated into companies. "Explanation" focuses on noncompliance with these good practices, such as failing to report or break down remuneration to the members of the management board and executive team. Another recent example of "explanation" is in gender equality policies, referring to the percentage of women in the workforce and, above all, in the management and administrative bodies.

In Spain and Brazil, stock market regulatory agencies believe the practice of "explanation" should be used to disclose behaviors that do not meet good governance standards. Thus, stakeholders—especially investors—can evaluate the quality of a company's corporate governance. The drawback of the explanatory practice proposed by regulators is that it occurs after damage to a company's economic performance or behavior has already been done. As it is said in Latin America, the explanation takes place "after Ines is dead," when it is too late to do anything.

The 'Panorama of Ethics and Transparency,' a recent survey conducted by the Brazilian Association of Business Communication (ABERJE) on organizations operating in Brazil, shows that 77 percent of companies have compliance committees, which are formal structures where perspectives on and corporate communication practices around governance are increasingly discussed. In Brazil, there are two institutions that work specifically to make recommendations regarding communications in the field of finance and investment, counter to financial tradition.

The Brazilian Institute of Corporate Governance (IBGC), founded in 1995, believes the new boost to communications is due to factors beyond setting limits on traditional organizational power and culture. In its Corporate Governance and Good Communication Practices Report, IBGC states that "communications plays an increasingly strategic role in organizations, contributing to value creation and improving results. In addition, society is more demanding, calling for a new pattern of communication and beginning to encourage participatory behavior, requiring commentary, discussion and positioning regarding organizations' activities."

ABERJE emphasizes this idea by stating that an organization's communications acquire systemic dimensions. "In today's society, 'organization' is synonymous with 'communications.' It is through communications, in their institutional, market, human and architectural dimensions, among



others, that an organization is perceived and expresses itself when relating to the public and its networks, with society and with markets. In this environment, marked by the production of intensive and convenient information, transparency, social participation, experience and old and new public problems, management committees and management boards must manage not only an organization's tangible aspects, but above all, its intangible ones."

In conclusion, the role of communications is not limited to explaining when there are breaches or deviations from standards. As a function and a skill, communications is the plasma that transports the nutritional substances companies must provide all those who relate to them. The simple thesis of "comply or explain" is unacceptable, as a sincere commitment to the explanation is essential, and because it is impossible to comply without explaining.



## G20/OECD SIX PRINCIPLES FOR CORPORATE GOVERNANCE

The six principles promoted by the OECD and G20 for the development of good corporate governance require the involvement of the communications department, whose most important mission is to create a culture of dialogue with stakeholders for the balanced management of all participants in business management.

The six principles are:

1. **Effective corporate governance framework**. It must promote transparent and fair markets, as well as an efficient allocation of resources. It must be consistent with the rule of law and provide effective support for supervision and compliance.

2. The **rights and equitable treatment** of shareholders and their key ownership functions. It must protect and facilitate the exercise of shareholder rights and the equitable treatment of all of them, including minorities.

3. **Institutional investors, stock markets and other intermediaries**. The mission of corporate governance is to incentivize communications along the entire investment chain and provide markets with information on how it contributes to good business management.

4. The **stakeholders' role in corporate governance**. The framework must recognize the rights of stakeholders, either as established by law or through agreements between the parties, and encourage active cooperation between corporations and stakeholders in creating wealth and jobs, ultimately contributing to the sustainability of a financially sound enterprise.

5. **Data disclosure and transparency**. It must ensure the timely and accurate disclosure of all material matters regarding the corporation, including its financial situation, performance, ownership and governance.

6. **Management board responsibilities**. It must guide the company's strategy, monitor the management team and uphold accountability to shareholders.

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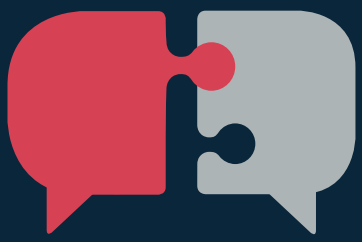

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IDEAS LLYC is a combination of global partnerships and knowledge exchange that identifies, defines and communicates new information paradigms from an independent perspective. Developing Ideas is a constant flow of ideas, foreseeing new times for information and management.

Because reality is neither black nor white, IDEAS LLYC exists.

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