Three surveys on **corporate governance**

Paul Coombes and Mark Watson

Investors say they would pay more for the shares of well-governed companies. It is hard to measure the market impact of these hypothetical premiums, but there is little doubt that good governance does make a difference.

Shareholders are growing increasingly active in the United States and elsewhere because they believe that better corporate governance will bring them higher rewards. Yet so complex is the relationship between shareholder activism and higher returns that repeated attempts by academics to show an irrefutable link between the two have failed.

With this in mind, McKinsey conducted three separate surveys to discover how shareholders perceive and, more important, *value* corporate governance in developed and emerging markets. Undertaken in cooperation with the World Bank, Professor Sangyong Park of Yonsei University, and *Institutional Investor*'s regional institutes, the surveys gathered responses from more than 200 institutional investors, which altogether manage about $3.25 trillion in assets (Exhibit 1).

The first survey, which examined attitudes toward investments in Asia, was conducted in September and October 1999 with *Institutional Investor*'s Asia Pacific Institute. The 84 respondents, 82 percent of which have invested in Asia, hold an estimated $1.05 trillion–plus in assets under management. The second survey, which looked at Europe and the United States, was conducted in October and November 1999 with *Institutional Investor*'s US and European institutes. The 42 respondents, 95 percent of which have invested in the United States and Europe, hold an estimated $550 billion–plus in assets under management. The third survey, examining investors' attitudes toward Latin America, was conducted in March and April 2000 with the World Bank. The 90 respondents, 70 percent of which have invested in Latin America, hold an estimated $1.65 trillion–plus in assets under management.

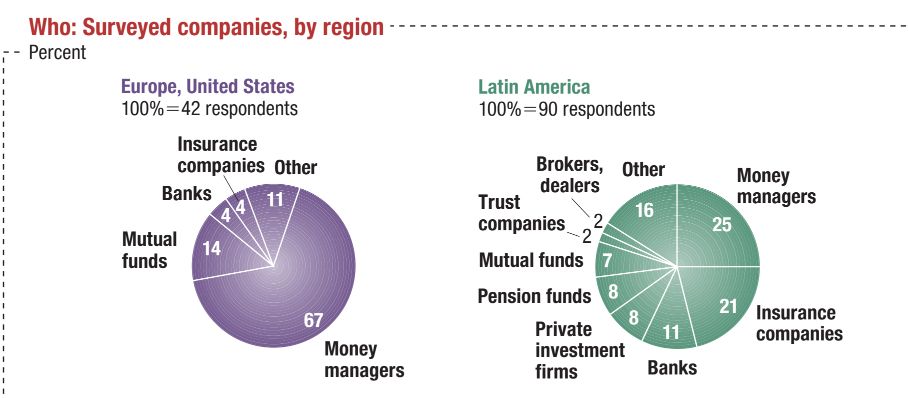
Paul Coombes is a director and **Mark Watson** is a consultant in McKinsey's London office.

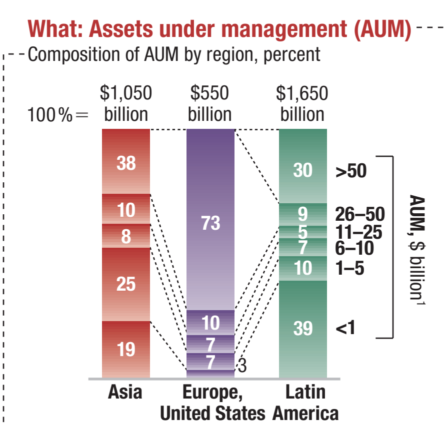
Three-quarters of the investors say that board practices are at least as important as financial performance when they evaluate companies for investment. For Latin America, almost half of the respondents consider board practices to be more important than financial performance. Over 80 percent of the investors say that they would pay more for the shares of a well-governed company than for those of a poorly governed one with a comparable financial performance. (A well-governed company was defined as one that has a majority of outside directors with no management ties on its board, undertakes formal evaluations of directors, and is responsive to requests from investors for information on governance issues.) Directors should also hold significant shareholdings in the company, and a large part of their pay should come in the form of stock options.

The premium the investors would be willing to pay for well-governed companies differs by country. Investors say that they would pay 18 percent more

EXHIBIT **1**

Inside the numbers: Who, what, where





Where: Location of company headquarters
Percent

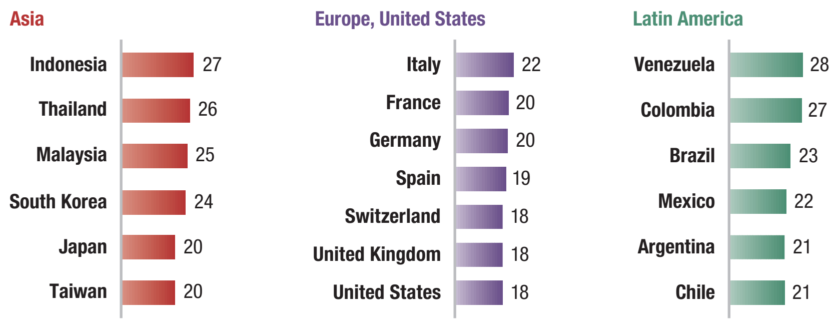
Location of headquarters	Regions surveyed: Asia	Europe, United States	Latin America
Asia	55	0	1
Europe	0	53	42
Latin America	0	0	31
United States	45	44	23
Other	0	3	3

[1] For respondents in Europe, United States, and Asia, the highest AUM category available was ">$25 billion."
Source: McKinsey investor opinion survey, 1999–2000

EXHIBIT 2

Relative premium: Measuring the value of good governance in 3 regions

Average premium that investors are willing to pay for a well-governed company, by region, percent



Source: McKinsey investor opinion survey, 1999–2000

for the shares of a well-governed UK or US company, for example, than for the shares of a company with similar financial performance but poorer governance practices. But they would be willing to pay a 22 percent premium for a well-governed Italian company and a 27 percent premium for a well-governed company in Indonesia (Exhibit 2).

In fact, the size of the premium the institutional investors say they are willing to pay for good board governance reflects the extent to which they believe that there is room for improvement in the quality of the financial reporting in a particular country. Financial reporting in Asia and Latin America, for instance, is both limited and, often, of distinctly poor quality. As a result, investors all over the world believe that their investments in Asia and Latin America are better protected by well-governed companies that respect shareholders' rights.

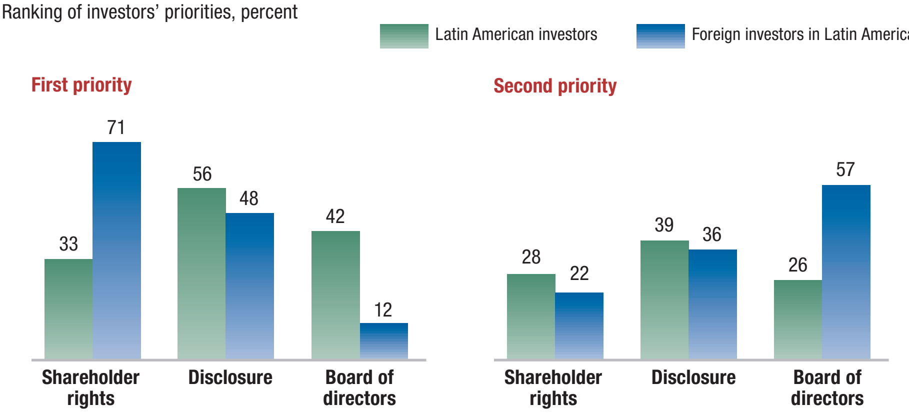
But in Europe and the United States, where accounting standards are higher, corporate governance is less important. Lower premiums for well-governed UK and US companies suggest, for example, that the investment community feels that they have already addressed many fundamental governance issues. Improvement in these areas can come only by fine-tuning current practices and by identifying innovative ways to raise governance standards further.

The premiums in Continental Europe suggest that, besides improved corporate governance at the board level, there is a need for more effective disclosure to shareholders of information on governance practices and financial issues. The still higher premiums in Asia and Latin America reflect the need for more fundamental disclosure of information and for stronger shareholder rights. In Latin America, local investors say that better disclosure is the main concern, while foreign investors see shareholder rights as the priority. For the foreign investors, the value of additional information is undermined if they

EXHIBIT 3

A difference of opinion

Ranking of investors' priorities, percent



Source: McKinsey investor opinion survey, 2000

cannot influence board or management decisions—as they can't when they are restricted to nonvoting shares (Exhibit 3).

Although it remains difficult to measure the market price impact of the premiums the investors say they would pay for well-governed companies, the amounts they are prepared to pay leave little doubt that good governance does feed through. The fact that most of the investors say that they already take corporate governance into account when making investment decisions is a powerful argument for corporate-governance reform.

Companies and policy makers should take heed. If companies could capture but a small part of the governance premium that is apparently available, they would create much greater shareholder value. Moreover, companies that fail to reform their governance will find themselves at a competitive disadvantage when they try to obtain capital to finance growth. High governance standards will prove essential to attracting and retaining investors in globalized capital markets; failure to reform will probably hinder companies with global ambitions.

It would be wrong to conclude from these surveys that good corporate governance is simple. An effective board of directors involves a combination of the right people, the right structure, and the right processes. Determining the appropriate combination for each individual company is the real challenge. And policy changes are likely to affect different countries differently, depending on existing cultural and economic practices. Each company and country should consider its own circumstances before choosing the best way to improve corporate governance. MQ