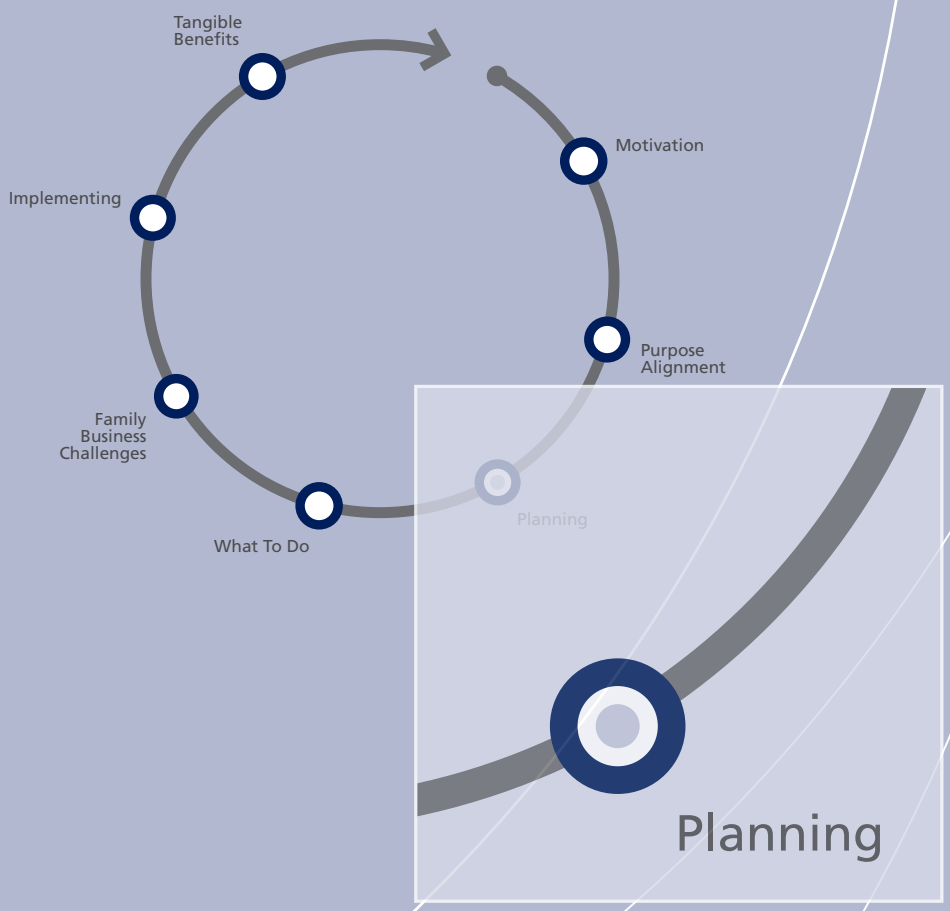
3

PLANNING AND SETTING PRIORITIES



Chapter 3:
Planning and Setting Priorities

KEY MESSAGES

Prioritize specific measures. Companies motivated to improve governance should seek to prioritize specific measures to ensure that proper attention is given to the most urgent tasks.

Look at what other companies are doing. Review governance practices of other companies in similar situations and examine the relevant corporate governance principles, standards, guidelines and literature to benchmark the current governance framework and practices and identify gaps and shortcomings.

Design a formal action plan. Putting the identified and prioritized corporate governance improvement measures into a formal action plan is critical. This will ensure that everyone in the organization understands what needs to be done, when and why. It will identify expected results and benefits and identify those responsible for implementation. A formal plan will also create accountability of all involved in the governance transformation process.

As in every complex transformation, setting priorities and balancing the desired results with efforts allocated are fundamental for success.

This chapter addresses factors to consider in the effort to prioritize governance improvement measures. It looks at the importance of self-examination and corporate governance benchmarking to get a clear vision of the current governance policies and practices. The chapter highlights sources of governance guidance and advice and lays out recommendations for the development of a formalized action plan for governance improvements. Companies Circle member experiences are presented throughout the chapter.

When leaders of companies first become familiar with good governance practices and become aware of the benefits achieved by those who have adopted them, they may find themselves confronted by two types of diametrically-opposed attitudes: excessive pessimism or over-optimism can both present obstacles to progress.

The pessimists. On the one hand, improvements may seem unachievable since the company's existing policies and practices may seem far from the desired goal. The company's leaders may lack a clear understanding of where to start or how to achieve desired results given available resources. They may not know that they can take intermediate steps towards better practices if it is not possible to reach best governance practices at once.

This attitude can force companies to question whether to embark on the process of governance transformation at all. The gap may seem insurmountable. Pessimistic leaders will need some time and some persuasion that implementing better governance practices can happen.

They will need to understand that while the process of improving governance may seem daunting, the progress achieved will reap benefits for all.

The optimists. On the other hand, some leaders may be excessively optimistic. They may not be realistic in assessing the difficulties they might encounter along the way toward implementing improved governance practices. They may believe that they can replicate in full the experiences of best-governed companies without considering whether doing so fits with their own goals and resources. Overly-optimistic leaders might feel that simply making the decision will allow the rest of the process to flow. This attitude carries significant risks as well, resulting in poorly-planned projects that jeopardize implementation and discredit the entire initiative.

1 Setting the Priorities

"We have established the fact that the implementation of corporate governance practices is a permanent process. But we must keep in mind that to implement all the best ones simultaneously, especially when a company is just starting out in the process, is virtually impossible. Many steps demand considerable analysis of future impacts and possible developments. Furthermore, the internal culture and dynamics of every company and its controlling shareholders must be respected. Otherwise, the entire process may be put in jeopardy."

—Leonardo Pereira, *NET, former CFO*

Every initiative should start by establishing the most important goals the company wants to achieve.

- What is the business case for improved corporate governance of the company?
- What are the areas of greatest risk that can be addressed by corporate governance improvements?
- Which decision processes and practices will produce immediate benefits?
- Which ones will have the greatest impact at least cost and effort?
- What transformations can be brought about most easily in the initial stages with the least resistance?
- What is realistically possible to achieve, based on the company's existing financial and human resources?

To find answers to these and other questions, companies should define their priorities or desirable actions in the short- and mid-term time frames to create the structure, flexibility, purpose and accountabilities needed to achieve the intended results. Reaching these initial targets will help convince the skeptics and encourage the indifferent.

Many factors influence the prioritization of governance improvement measures. Companies might have some relatively good governance policies and practices in certain areas, while in other areas their practices could be weak or non-existent. For example, at some firms, governance shortcomings might be more apparent in the area of board practices, while for others internal controls and auditing may pose significant problems.

Some governance measures require pre-conditions, while others are stand-alone and can be implemented independently of other measures. Some may be relatively easy to implement as single measures with little potential for resistance; others may be more complex, involving a more difficult set of trade-offs and greater potential for resistance. These measures might require a lengthy period for implementation.

With such a variety of measures and intricacies of implementation, how should a company identify its priorities?

1.1 Motivations Drive Prioritization

As discussed in Chapter 1, the motivation for governance improvements will drive the agenda and pace of actions.

- For companies looking to attract minority investors, measures aimed at boosting potential investors' confidence that their interests will be respected is a good place to start. Thus, governance policies on shareholder rights, information disclosure, tag-along rights for preferred (non-voting) shares, and board representation might be some of the measures to undertake.
- For companies seeking to improve decision-making processes and operational results, rules and procedures for decision-making at shareholders' meetings, board meetings and at the senior management level may be the priority.
- For family-owned companies interested in expanding or optimizing the organization, family business governance measures might be the focus of governance improvements. For more detail on such issues, see Chapter 5.

Often, companies face more than one of these situations at the same time. In such cases, it would be up to the company leaders to decide where to start, depending on the areas that require the most urgent intervention.

Prioritization of governance improvements will also be affected by the size of the company, the financial and human resources that are available, and the specific demands of the market and investors. Other factors include internal compromises on priorities among the various stakeholders of the company.

Start Here: A Checklist for Prioritizing Your Governance Actions

- ☑ Analyze your current governance practices
- ☑ Define resources to be dedicated
- ☑ Look at what other companies in similar circumstances are doing or have done
- ☑ Compare your practices to the competitors' to understand the value

External consultant helps set CCR priorities.

CCR needed to focus internally, given the nature of the company's formation as a group comprised entirely of minority shareholders—and competitors in the heavy construction business.

Because the company itself was created with the help of an international consultant, this process was used to set governance priorities as well. The partners came together and learned about the importance of effective corporate governance especially tailored for CCR. Together, with the help of the consultant, they identified a corporate governance to-do list.

Ferreyros' governance self-assessment helps prioritize changes

At **Ferreyros**, company leaders realized that continuous change is best implemented when a company's current status has been assessed internally and benchmarked both domestically and abroad. As described in Chapter 2, the company joined into an association with other firms interested in corporate governance practices. Each company in the group was asked to complete a governance self-assessment questionnaire looking at several areas:

- Transparency of ownership
- Financial transparency
- Board structure and procedures
- Shareholder relations

In general, the company scored well on the assessment, but in some areas, the company was not as strong. Company leaders used the results of the assessment as a starting point to implement improvements based on areas in which progress was not as satisfactory.

Suzano prioritizes listing on Brazil's corporate governance exchange

Part of the capital markets strategy of **Suzano Papel e Celulose** and **Suzano Petroquímica** included goals to list the first on Level 1 and the later on Level 2 of BM&FBOVESPA's corporate governance segments. Improvement priorities were geared towards meeting the requirements for inclusion in these select groups. A number of steps were taken to meet these goals:

- Adding three independent members to the boards of directors at both Suzano Papel e Celulose and Suzano Petroquímica, including one elected by minority shareholders
- Publishing Suzano Petroquímica's financial statements in US GAAP, meeting BM&FBOVESPA's Level 2 corporate governance requirements within the established deadline

- Completing the implementation of the Suzano Group's code of conduct in mid- 2006, following extensive discussion
- Defining the new board committee structure for Suzano Papel e Celulose and Suzano Petroquímica, including implementing an audit committee and expanding the scope of the strategy committee to incorporate sustainability
- Formalizing the new co-CEO structure at Suzano Petroquímica: the chairman of the board of directors stepped away from the CEO position, and a management committee under the board of directors was created in September, 2006. Suzano Papel e Celulose had a similar structure in place already.

2 The Role of Benchmarking

In the process of planning governance improvements and setting priorities, benchmarking[21] plays an important role in guiding the company as shown below.

	Benchmarking Process
Purpose of Benchmarking	› Identify and verify the company's position relative to governance policies and practices › Define what the company could/should do to improve › Define the path and prioritize the actions for governance changes › Verify that the company is on the right track once improvements are underway › Evaluate and uncover trouble spots that do not conform with the identified standard
Sources of Benchmarking	› Surveys, academic studies and other publications of corporate governance practices – Interaction with other companies – External partners – Corporate governance associations – Stock exchanges – Regulators – Multilateral organizations – Research and academic centers – Professional and trade associations – Governance rating agencies
Types of Benchmarking	› Against peers in the industry, country, region or worldwide › Against recognized national or international corporate governance principles and standards

An efficient way to benchmark is to search for governance developments in peer companies of the same industry. It is critical to find companies with properly-implemented governance practices to understand the implications and justifications for following such practices, as well as to get a sense of how to implement them in your own company.

[21] For a list of Latin American and other international sources of information on corporate governance that may also support guidance on benchmarking against best practices, see Appendix 2

What kinds of outputs are expected from a benchmarking exercise?

- Framework for discussion among company leaders, where differences may arise
- Consensus on directions to take[22]
- List of corporate governance deficiencies that improvement efforts will address
- Clear, feasible direction and pace of change to which all parties at the table agree
- Governance improvement plan with properly established priorities

While benchmarking is a recommended approach, Companies Circle members can attest that finding full and relevant information in Latin America remains a challenge.

Argos Searches for Governance Benchmarks

In Colombia, governance regulation was not yet well developed when **Argos** sought to compare its governance policies and procedures with what other comparable firms in the country were doing. Argos wanted to make sure its practices were consistent with or better than these other companies.

Argos also looked abroad to review the corporate governance framework and practices in other markets. The company analyzed the guidelines of the NYSE and the Brazilian Institute of Corporate Governance. Leaders also reviewed the discussions and publications of the Latin American Corporate Governance Roundtable, organized annually by OECD and IFC/World Bank Group since 2000.[23]

The company engaged external consultants to assist in developing the benchmarking framework. Argos' leaders say that the process itself was important, enabling the company to consider the views of clients, shareholders, regulatory agencies, capital markets analysts and financial media. The result: Argos created an excellent code, which is currently applied and against which the company's practices are assessed.

Next steps include evaluating existing policies. With all references in hand, the next step is to proceed with a meticulous evaluation of existing governance policies, processes and practices within the company, comparing them against the benchmark. This means producing a technical assessment. It also means generating significant discussion and analysis among company leaders about current practices and what they say about the company's culture and way of doing business.

To help with this assessment this Guide produced a 100-point benchmarking questionnaire to serve as a self-evaluation tool that will allow companies to compare its governance practices with those valued by market agents. The benchmarking questionnaire is explained in Chapter 4 and included in Appendix 3

Following the benchmarking analysis of current governance successes and shortcomings, companies may find it useful to learn more about relevant governance policies and structures they will need to put in place and how better practices can be implemented.

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22 Given the impact of possible changes on the organization, do not expect immediate consensus. Unrevealed reservations in the beginning may become important obstacles to future developments, so it is crucial to understand sources of resistance wherever they may originate, and to discuss them frankly.

23 See *www.oecd.org/daf/corporate-affairs/roundtables*.

3 Sources of Advice and Guidance

The good news is that there is no shortage of resources on governance assessments, action plan development and implementation of improvements. Much of what you find useful will depend on the internal culture of your firm, though. Some companies use external consultants. Others contact corporate governance institutes or chambers of commerce. Still others may educate themselves by visiting corporate governance websites, reviewing the relevant literature, and networking to learn from other companies' experiences.

One such source for self-evaluation your company's governance policies and procedures is from IFC, which has developed a series of progression matrices for different types of companies. The matrix for listed companies identifies main areas of corporate governance covering:

- Company leadership's commitment to good governance principles
- Functioning of the board of directors and the senior management
- Control environment, including internal control, risk management and compliance systems
- Information disclosure and transparency
- Protection of shareholder rights

In each of these areas general practices are identified that are recognized as acceptable, good, advanced or best (levels of governance development). While the main purpose of the matrix is to provide a framework for the company's leadership to discuss the big picture of the required governance improvements, it also is very useful for defining the ultimate goal of the company in each area and the next logical steps to move up the corporate governance ladder towards best practices.

See Appendix 1 for the listed company matrix,[24] and Appendix 2 for other sources of information.

Case Study: Short Timeframe for Compliance Drives Atlas' Hiring of Consultants

New rules from Costa Rica's stock market regulators included a speeded-up deadline for compliance. Given the short time frame, **Atlas**' board of directors decided to hire outside consultants to help them in the efforts that would be required, especially when it came to internal control procedures. They contacted the local office of an international consultancy, which immediately dispatched a team . The team held several meetings with the company's management, and the project was initiated.

Divide and conquer—splitting the tasks. Based on the consultants' advice, company leaders divided responsibilites among various key players:

- The general manager and CEO was the sponsor of the project
- The CFO held the lead role for project implementation
- A consultant from external firm handled project coordination

The company set up a steering committee as well. The workplan that evolved from the

[24] Other progression matrices of IFC as well as additional useful resources can be found on www.ifc.org/corporategovernance.

initial assessment was discussed and approved by the board's audit committee. Work was initiated on developing a list of priority procedures, based on a risk matrix prepared by the steering committee.

Evaluating the results. Company leaders report that progress has been slow but steady.

- Priority has been given to the development of internal control policies and procedures because they have the largest impact on the company.
- The mix of external consultants and company officers has worked well: although the company's officers were the ones who could best describe their roles and define specifics of what was needed, they could not stop their day-to-day responsibilities to dedicate themselves full-time to the implementation of the needed governance changes.

Here is how Atlas CEO Diego Artiñano describes the situation:

"Once the CONASSIF came out with the new regulation we were faced with the fact that to be able to ensure compliance with it, something for which both the chairman of the board and myself had to deliver a sworn statement, the proper systems and controls had to be in place. By evaluating the task in front of us, the required knowledge to do it effectively and the effort required, we searched for options and ended up deciding on the external consulting firm. The challenge was not to do the effort to please the regulatory agency and comply, but also to bring some value to the business processes. This approach has made the difference. Processes must be adequate to perform under new requirements and not involve adding "second stage operations and controls" to make them compliant. Although this approach has taken some more time to complete, we cannot report a relevant increase in costs due to the new controls and compliance requirements. Atlas has been a leader in Costa Rica in several areas. Being the first publicly traded company in Costa Rica, we feel that we also are called to lead related actions."

—Diego Artiñano, *Atlas, CEO*

Companies Circle members took divergent approaches as they sought improving their corporate governance policies and procedures. Here is a look:

Single-source advice

Atlas decided to engage external consultants after Costa Rica's stock market regulator introduced new regulations on corporate governance, with shorter deadlines for compliance than previously mandated.

Multi-source advice

At **Ferreyros**, the company accepted input from all its stakeholders, including:

- Investors
- Market intermediaries
- Corporate governance institutes
- Documents published by corporate governance institutes
- OECD guidelines and the Peruvian principles published by Conasev
- Involvement in the Procapitales Association's corporate governance committee
- Institutional investors: specifically, the company implemented their suggestion to include more independent directors.

"In the early 90's many foreign investors took an interest in Peruvian companies by investing directly in the Lima Stock Exchange, including in our company. We started getting calls from investment bankers to visit with analysts who were traveling to Peru. Then, in 1997 we placed capital stock internationally and our arranger and placer recommended that we include elements such as a dividend policy, distribution of press releases and hosting a conference call. By this time, local institutional investors such as pension funds also started to invest in our company and to meet with us. We always received—and continue to receive—valuable comments at these meetings about managing risks, structuring financings, and relating to the capital markets, among others. We try to implement most of them."

Mariela García de Fabbri, *Ferreyros, CEO*

4 Less Is More: Design an Easy-to-Understand Roadmap

Once all the analysis has been done and priorities set, it is time for the company to put together an action plan for implementing corporate governance improvements.

Sometimes, company leaders will keep the plan in their heads. Still, a formal action plan will serve to institutionalize the changes and introduce accountability for those responsible for implementation and oversight. The formal action plan clearly sets the expectations as to when governance measures will be implemented and when expected results of improvements will materialize.

With a formal action plan readied, you can create a simple roadmap to identify the actions. Items in the plan might include:

- Indicating specific governance actions
- Setting up information communication mechanisms: intranet, email
- Specifying each expected result of the governance improvement process
- Defining the amount of time allocated for implementing each element of the plan
- Identifying the milestones that will indicate the progress achieved and clear and measurable indicators for each intended result
- Naming the person responsible for each action

Keep it simple! The simpler your action plan, the easier it will be for everyone to understand their roles and for company leaders to monitor the implementation.

Figure 3.1 shows what an action plan might look like. This chart groups possible corporate governance improvement measures into the CG Action column. These measures are consistent with the recommendations of the OECD Principles of Corporate Governance, specified in the CG Area column.

An actual plan also would include timelines for completion, designation of responsible parties and comments to highlight any challenges or special considerations in relation to the specific action.

Figure 3.1 Sample action plan

	CG Area	CG Action	Timeline	Responsible Party	Comments
1	Commitment to CG	› Hire a CG consultant to assist in reviewing and implementing CG reform			
2		› Develop a corporate CG code			
3		› Establish corporate governance committee and develop TORs for the new committee			
4		› Develop a code of ethics: implement whistle-blowing procedures			
5					
6	Board Practices				
7	Control Environment				
8	Information Disclosure and Transparency				
9	Shareholder Rights				

Note that the example here is illustrative, and not prescriptive. There is a wide range of possible actions to consider and adapt, according to your company's unique circumstances and priorities. You will find further guidance on recommended governance actions in the next two chapters of this guide.

Once your plan is formalized, it must be communicated to all stakeholders.

Hint: setting incentives or rewards for each level of the team involved in the process can help to motivate their efforts in the implementation process.

This chapter addressed the need for good preparation before starting out on the journey towards implementing governance improvements. It explored the importance of understanding the company's current stage of development and highlighted the value of setting priorities and knowing the direction in which the company is heading. The next chapter looks at specific improvement measures companies can make.

For Further Thought and Discussion:

- How would you prioritize the efforts to improve governance policies and practices in your company?
- What corporate governance improvement measures would you seek to implement immediately?
- What relevant resources are available or could be mobilized to develop an action plan specific to your situation?
- Have you identified governance benchmarks to evaluate where your company is compared to others and what actions require prompt response?
- Using a framework similar to the figure above, start to think about specific actions that will drive these improvements.