

Corporate Governance Has Mattered Even More in a Crisis

Featuring: **Ric Marshall**, Executive Director, MSCI ESG Research

Adam Bass:

This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass, and today is August 20th, 2020. This week, corporate governance. It's often overlooked when times are good and the proverbial tide is carrying everyone along. But when crisis hits and that tide rolls out, it becomes very easy to see who's swimming naked. One person who had been paying attention to this issue for decades is Ric Marshall, executive director on the MSCI ESG research team. We spoke with Ric about the role that good and bad governance has played during the pandemic. Ric, thank you so much for joining us. We've wanted to have you on the program for quite a while now.

Ric Marshall:

Oh, that's great to hear. Thank you for having me on, Adam.

Adam Bass:

Now, before we get started talking about governance, your area of specialty, you actually have another area of specialty that we've all had to learn over these past six months or so, and that is working from home, which you had been doing before the pandemic hit. But all the same, I'm curious if anything's changed for you.

Ric Marshall:

Oh, it was a dramatic change actually, but not what you might think. Having worked primarily from home for several years prior to the pandemic, I'd actually settled into a pretty comfortable routine. Then suddenly all of my colleagues, all of my clients, all my key contacts were also working from home and pretty much online all day long. So what happened for me was this sudden invasion of my office. I mean, that's literally what it felt like. I felt like my life had been disrupted because suddenly everybody was in the same space as me. Where everybody else had to start learning how to be in touch more in

the virtual world. I found myself having to do things like, oh, I would add a nonexistent appointment on my calendar just to be able to carve out enough private time to do my own research and writing.

Adam Bass:

You're always on.

Ric Marshall:

Exactly. Right.

Adam Bass:

Well, hopefully we'll get back to some degree of normalcy soon. On this program, we've actually talked a lot about ESG and its resilience during the crisis. But as you mentioned, your work focuses specifically on the G part, governance. So what I'd like to do is start by having you simply define what does that mean? What is corporate governance?

Ric Marshall:

Corporate governance refers to the point of connection between a company's investors and its managers. So it includes various ways and means of guiding a business, the policies and practices that we think of as governance structures, but also most importantly it includes a distinctly human element in the form of a board of directors. Executives at accompany are charged with running the company, with devising and actually executing company strategies. While directors are charged with strategic oversight of that executive team, looking out for our investor interest, whether they're shareholders or creditors alike.

Adam Bass:

Tall order, indeed. So what does good corporate governance look like?

Ric Marshall:

At its best, good corporate governance is almost a magical thing, and I mean that in the sense that it's invisible. You don't really see good corporate governance. It requires a combination of individual skills and experience and a degree of dynamic interaction between the board members. That's really kind of

hard to put a definition on. Ownership dictates the best approach for corporate governance. So when you ask me what good corporate governance looks like, the first thing I'm going to do is ask you a question, what's the ownership. Is this a widely held, decades old multinational company? Or is this a recently IPO controlled company that's run by the founder and still aspiring to very rapid growth?

Ric Marshall:

Different companies, different boards, different approaches to corporate governance, and potentially very different versions of what comprises good corporate governance. Of course, we track all sorts of very specific corporate governance practices, things like leadership and board independence, but we're really far more concerned about identifying poor corporate governance. Weak or poor corporate governance is nearly always value destroying, sooner or later.

Ric Marshall:

In the midst of the current crisis, it's actually pretty easy to spot the weakest boards, the companies with the poor corporate governance practices. You don't really see this when the markets are rising. Who cares about weak corporate governance when everything is doing great? But in a crisis like this one, bad corporate governance is like a rotting step. You might not even know it's there until you fall right through it. But that's why we try to assess this and have developed the approach that we have to help spot the rotting steps before we crash through.

Adam Bass:

Looking back over the last six months, if good corporate governance is something that you don't see per se, you do see it in the results. I'm curious what kind of rewards have good governance brought to the companies that practice it during this recent crisis?

Ric Marshall:

That's a great question. One of the most important aspects of good corporate governance, one of the most important consequences of good corporate governance is this idea of resilience. Good corporate governance is not just a static state, but it's a dynamic contributor to the health and wellbeing of a company. So the best boards are the ones that encourage their company's executives to be creative, to think outside the box, to take appropriate risks, the kind of support that gives them the confidence needed to take more decisive action, to be more effective managers, while at the same time being mindful of the need to protect and preserve their investors' capital.

Ric Marshall:

For many companies, the biggest challenge they're facing right now is the constant back and forth between short term reaction and longterm strategy, between surviving the crisis today, while at the same time better positioning the company to take advantage of tomorrow's opportunities. Entire portions of the global economy have been effectively decimated, and it's not just a problem of disruption, it's also the rapidity with which things are changing, as if an accelerant had been poured on a fire. Things are raging out of control. Good corporate governance becomes one of the rocks on which we base our response.

Adam Bass:

So right before everything hit and COVID shut everything down, there was a lot of attention especially in the press and in industry papers about something called stakeholder capitalism. That is the idea that corporations and boards need to think about the idea that they don't just exist to serve shareholders, which has been the operating principle for decades. This included a lot of high-minded statements from the World Economic Forum just this past January. I'm curious, given everything you just said and given everything that we've been through and these companies have been through the last six months, has there been any movement, some practical action toward the idea of stakeholder capitalism taking effect?

Ric Marshall:

The most recent study that I've seen on this question concluded, and it's very recent, like in the last week or so, this was published, the conclusion was that these statements were perhaps aspirational at best, and at worse, nothing more than PR. In our own ESG trends report, which came out really early this year ahead of the pandemic, we concluded that most stakeholder groups would not be satisfied by words alone, that there would be a lot of close scrutiny as to what these companies actually did. Then of course, the pandemic hit and threw everything into chaos.

Ric Marshall:

But even then at that point, we were very clear in noting that of all the various stakeholder groups cited in these statements, shareholders were the one group best positioned to have a real impact around this idea and were in fact motivated to do so. So I would turn this around a little bit. I would say that the better question would be to ask whether global investors have started act on those statements. I think this will be up to investors, not the CEOs, which of course from my perspective makes strong corporate governance more important than ever.

Adam Bass:

Looking beyond the crisis a bit, before it hit, everybody thought the great global crisis, the one that would affect us all, investors, not investors, every type of company and government would be climate change. Of course, that's still out there. It hasn't gone away. It's just that COVID sort of jumped the line, let's say. But are there lessons for dealing with climate change that boards as well as investors can take with them?

Ric Marshall:

Absolutely. First and foremost, get ready. The pandemic caught us mostly off guard, but as horrible and difficult as it's turned out to be, it's also turned out to be a relatively manageable crisis. Most large public companies at least have been able to shift and dodge and keep the lights on. The climate change crisis won't be so easily managed, particularly if we wait too long. In fact, it's already started. I mean, we're seeing early warning events all over the planet. Those kinds of events are only going to become more frequent and increasingly more severe. The reality is that the next great crisis, climate change, is already looming on the horizon. For boards, for executives and for investors, climate strategy and climate governance should be top of mind.

Adam Bass:

That's all for this week. Thanks to Ric and to all of you for joining us. Remember, it takes just a moment to subscribe to the podcast, leave a comment or share with a friend. Until next week. I'm your host, Adam Bass and this is MSCI Perspectives. Stay safe, everyone.

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