



Helping Boards Be Even More Effective Problem Solving Units

ASSOCIATION FOR STRATEGIC PLANNING

April, 2009

SPEECH BY DR. LAURENCE STYBEL OF BOARD OPTIONS, INC. AND THE SAWYER SCHOOL OF BUSINESS AT SUFFOLK UNIVERSITY.

Implications of Ver 3.0 of the Institutional Shareholders Services Corporate Governance Quotient (CGQ) for strategic planners.

SUMMARY:

CGQ stands for Corporate Governance Quotient, a service of Institutional Shareholder Services.

The common assumption is that 7500 companies in the North America, Europe, and Asia, are evaluated yearly and the CGQ score is used by ISS to justify its recommendations to subscribers for voting for and against the re-election of the Board as well as other votes brought before shareholders at annual meetings.

It is also thought that CGQ scores are purchased by institutional investors as a risk management tool. Lower scores have higher probability of shareholder law suits. But high scores are not necessarily predictive of anything.

In my presentation I will seek to show that these assumptions are both correct and too limiting. Version 3.0 of CGQ is fundamentally different than Version 1.0 and 2.0. CGS distribution channels are much wider than many business professionals are aware of.

As Boards begin to grasp the new distribution and statistical implications of Ver 3 of CGQ, I believe that this will cause some changes in the charter of Nominating & Governance Committees of Boards of Directors in the direction of explicitly monitoring CGQ scores annually and recommending a course of action to the Board of Directors.

Directors that are not familiar with CGQ need to become familiar with it. Directors and CEOs who are familiar with CGQ and are angry at Institutional Shareholder Services need to focus on what ought to be done beyond displays of ineffective anger.

WHAT IS CGQ?

Institutional Shareholder Services (ISS) is a division of a public company called Risk Metrics Group, Inc. ISS developed The Corporate Governance Quotient (CGQ) to provide institutional investors with a measurement tool to evaluate governance risk. Low scores would be associated with low shareholder performance and a high probability of shareholder class action lawsuits. I want to stress that the tool was designed for institutional investors and the focus was on identification of investment risks.

It has two popular uses: (1) CGQ is used to justify ISS recommendations to recommend votes for or against Board of Director candidates at annual meetings. These recommendations are given to institutional investors who sign up for ISS services (2) institutional investors use CGQ scores as a factor in determining risk. Low scores are correlated with high potential of class action shareholder law suits. But high scores don't have predictive validity.

CEOs and Board members often have strong negative perceptions about CGQ and ISS:

1. CGQ is arbitrary. It substitutes logic/reason for compliance to more mindless rules that have no relationship with profitability.
2. ISS is unethical. They exploit their position as good governance referees with a consulting service to boost ISS scores. The criterion employed is not transparent, thus requiring assistance. Think of a basketball referee saying that he won't disclose how he makes penalty calls. You will just know it when he calls it. But for a fee he will teach you how to get around him and comply with him.

THREE VERSIONS OF CGQ

CCQ Ver. 1.0

Began June 2002. 18 month review with a panel of outside governance experts. ISS criteria.

Version 2.0 was created in 2003 to conform to the new Sarbanes Oxley laws. Requirements under SARBOX can't differentiate between good governance and bad governance. SARBOX linked requirements were eliminated from Ver 2.0.

VERSION 3 was created in 2005 by looking at the universe of CGQ ranked companies statistically.

Between 2003 and 2004 ISS performed more than 4,000 statistical tests. Each of the 77 factors making up CGQ measurement from 2002-2004 was statistically tested against 16 performance measures (P/E, beta, ROI, ROE, ROA, etc.).

Version 3.0---statistically driven; looking at correlation between poor performance and unpleasant things happening to shareholders but also good performance on CGQ and positive things happening like ROA.

ISSUE #1: evidence based approach versus conceptual approach

The Correlation between Corporate Governance and Company Performance

Below is a link to research conducted by Professor Lawrence D. Brown, Ph.D . Distinguished Professor of Accountancy Georgia State University. This research was funded by ISS and there has been no replication to date.

http://www.tkyd.org/files/downloads/corporate_governance_study_104.pdf

1.

Firms in the bottom decile of industry-adjusted CGQ° (Corporate Governance Quotient) have 5-year return on investment that are 5% below the industry average, while firms in the top decile of industry-adjusted CGQ have 5-year returns that are 19% above the industry-adjusted average.' The difference in performance between these two groups is 24%.

You see similar dramatic data when you look at price volatility over a 3 to five year period; return on assets; and return on investment.

What CGQ factors are driving this trend?

Most important is Board Composition. Least important is take over defenses.

VERSION 3.0: NEW DISTRIBUTION CHANNELS

The distribution outlet for CGQ are now limited to anyone in the world with access to the Internet. Just go to your favorite search engine and type "yahoo finance profile (name of company or stock symbol). The CGQ scores appear on the right side of the screen. And remember that CGQ measured over 5,000 public companies around the world. It no longer is a U.S.-only measure.

FUTURE USES OF CGQ BASED ON THE NEW DISTRIBUTION CHANNELS AND NEW STATISTICAL ANALYSIS.

HOW I HAVE USED CGQ IN RETAINED SEARCH AND CAREER CONSULTATION.

IN RETAINED SEARCH

AS AN INVESTOR

APRIL 2, 2009 MOTLEY FOOL USING CGQ RATINGS AS PART OF THEIR FACTORING IN RECOMMENDING STOCKS: good quality companies that treat their shareholders right that you can take pride in holding on to for the long term.

HOW MEMBERS OF THE ASSOCIATION FOR STRATEGIC PLANNING CAN USE CGQ:

IF GROOMING YOUR COMPANY TO BE ACQUIRED BY A PUBLIC COMPANY.

IF GROOMING YOUR COMPANY FOR AN IPO.

IF LOOKING FOR ACQUISTITION TARGETS:

AS A PIECE OF DATA IN DETERMINING WHERE YOU MIGHT WANT TO WORK:

CGQ should always be perceived as a piece of data that needs to be taken in context: General Motors has a CGQ at the 99th percentile of S&P 500 Companies and COSTCO has a very poor ranking!!!

CGQ FACTORS

The CGQ rating factors for U.S. companies are listed by rating category below:

Note: Some of the ratings factors are also looked at in combination under the premise that corporate governance is enhanced when selected combinations of these criteria are adopted.

Board

1. Board composition
2. Nominating committee composition
3. Compensation committee composition
4. Governance committee
5. Board structure
6. Board size
7. Changes in board size
8. Cumulative voting
9. Boards served on - CEO
10. Boards served on - Other than CEO
11. Former CEOs on the board
12. Chairman/CEO separation
13. Governance guidelines
14. Response to shareholder proposals
15. Board attendance
16. Board vacancies
17. Related-party transactions -- CEO
18. Related-party transactions - Other than CEO
19. Majority Voting

20. ISS Recommendation of Withhold Votes

Audit

21. Audit committee
22. Audit fees
23. Auditor ratification
24. Financial experts
25. Financial Restatements
26. Options Backdating

Charter/Bylaws

27. Poison pill adoption
28. Poison pill - shareholder approval
29. Poison pill - TIDE provision
30. Poison pill - sunset provision
31. Poison pill - qualified offer clause
32. Poison pill - trigger
33. Vote requirements - charter/bylaw amendments
34. Vote requirements - mergers
35. Written consent
36. Special meetings
37. Bylaw amendments
38. Capital structure - dual class
39. Capital structure - blank check preferred

State of Incorporation

40. State of incorporation antitakeover provisions
41. Control share acquisition
42. Control share cashout
43. Freezeout
44. Fair price
45. Stakeholder law
46. State endorsement of poison pills

Ownership

47. Director stock ownership
48. Executive stock ownership guidelines
49. Director stock ownership guidelines
50. Officer and director stock ownership levels
51. Mandatory holding period for stock options
52. Mandatory holding period for restricted stock

Executive and Director Compensation

53. Cost of option plans
54. Option repricing permitted
55. Shareholder approval of option plans

56. Compensation committee interlocks
57. Director compensation
58. Option burn rate
59. Performance-based compensation
60. Option expensing

Progressive Practices

61. Board performance reviews
62. Individual director performance reviews
63. Meetings of outside directors
64. CEO succession plan
65. Board can hire outside advisors
66. Directors resign upon job changes

Director Education

67. Directors participating in director education programs

Combination Factors

68. Board Composition and Ownership
69. Board Composition and Key Committee Structure
70. Proxy Contest Defenses

Calculating the CGQ - US companies To generate a CGQ for each company, ISS analysts use public available documents and Web site disclosure to gather data on 63 different issues in the following four broad rating categories: 1) board of directors, 2) audit, 3) antitakeover, and 4) compensation/ownership. Based on this information and a scoring system developed by an external advisory panel and ISS, the next step is to calculate a CGQ for each company. While each variable is evaluated at on a standalone basis, some variables are also looked at in combination under the premise that corporate governance is improved by the presence of selected combinations of favorable governance provisions.

Each company's CGQ is compared with other companies in the same index and industry group.

All scores are relative (percentile basis)

CGQ index score: compare to Relevant Market Index including: S&P 500, Mid-Cap 400, Small-Cap 600, Russell 3000, and CGQ Universe (remaining companies covered by CGQ but outside the Russell 3000). Note that when CGQ refers to a "Russell 3000" CGQscore, it is referring to Russell 3000 companies MINUS the three S&P Indices).CGQ industry score: compare to industry peer group based on the S&P "GICS" (Global Industry Classification System) of 24 industry groups

CGQ Ratings Example: Microsoft scores 75% CGQ index score and 97% CGQ industryscore. This means that Microsoft is doing a better job (outperforming) in terms of corporate governance practices and policies than 75% of the other companies in the

S&P 500. Likewise, Microsoft is outperforming 97% of the companies in the Software & Services Group.

CGQ Subscores provide a measure of a company's governance in a particular governance area by ranking companies into quintiles relative to a relevant index and industry group.

Subscores are calculated for four categories:

- * Board
- * Takeover Defenses
- * Executive and Director Compensation and Ownership
- * Audit

Subscores are expressed from 1-5

- * 5 indicates company is in the top quintile in a governance area.
- * 1 indicates company is in the bottom quintile in a governance area.

CGQ Data Collection - US Companies

- * Data collected from SEC EDGAR filings (i.e. Proxy Statement, 10K, 8K, Guidelines...), Press Releases and Company web sites.
- * ISS re-profiles companies every 120 days, or at least 3 times per year.

Should issuers provide comments about the CGQ data to ISS in between profiles, ISS will review the comments, fact check each requested data point change, correct/update the profile as necessary and check the remaining CGQ data points not addressed by the issuers.

- * ISS provides all companies with a unique account number, password and hyperlink to review the CGQ data collected for the company.
- * ISS emails Issuers when a change is made to its' CGQ data and request the company verify the information changed. The email will contain the account number/password and hyperlink to the corporate web site to facilitate the process by which the company may verify that changes were made.
- * All changes to an Issuers CGQ data are date stamped based on when the review took place and the clock re-started such that the company will be re-profiled in another 120 days, or sooner if the company requests changes before that date.
- * All requests for updates are acted upon within one business day, worst-case scenario two business days.

Corporate Governance Quotient Coverage

- * A corporate governance rating system and corporate governance database updated daily on over 7,400 companies worldwide that evaluates the strengths, deficiencies and overall quality of a company's corporate governance practices and board of directors.

MOTLEY FOOL

April, 2009

Top-Rated Stocks That Treat Shareholders Right

By Rich Duprey

Since 2002, Motley Fool Stock Advisor has outperformed the S&P 500 by 36 percentage points. Join David and Tom Gardner in Stock Advisor today.

The flip side to shareholder-friendly stocks expected to underperform the market? Highfliers that pay little heed to their owners' interests. Conversely, there are top-flight companies that also treat their shareholders with respect.

Institutional Shareholder Services -- the big name in corporate proxies -- measures how well a company performs in as many as 63 categories covering four broad areas. Moreover, each company is scored relative to its market index and its industry group. It assigns the stocks a rating that it calls its corporate governance quotient, or CGQ.

Some evidence supports the notion that companies with weaker governance have higher risk, decreased profitability, and lower valuations. We'll be looking at stocks that [Motley Fool CAPS](#) investors have marked to outperform the market and that also sport above-average CGQ scores, either in their index group or among industry peers.

Company	CAPS Rating (out of 5)	Index CGQ Ranking [^]	Industry CGQ Ranking [^]
Cliffs Natural Resources (NYSE: CLF)	****	98.2%	98.6%
Duke Energy (NYSE: DUK)	*****	82.6%	90.1%
FedEx (NYSE: FDX)	****	84.2%	96.4%
Harvest Natural Resources (NYSE: HNR)	*****	96.1%	92.9%
McDonald's (NYSE: MCD)	****	54.4%	95.1%

Source: Yahoo! Finance, Motley Fool CAPS.

[^]Relative placement when compared with companies in index or industry. Higher is better.

Although finding good companies and holding them for the long term is one of the [greatest secrets](#) to investing success, there are many factors an investor should consider, and how well a company treats shareholders shouldn't be least among them. View these rankings as a way to gauge how these businesses stack up against one another relative to their shareholder policies.

###

ABOUT BOARDOPTIONS, INC.

Boardoptions, Inc. saves Board member time by providing expertise to Nominating and Governance Committees in the following areas:

- A structured procedure for the Board of Directors to identify both functional and problem solving perspectives needed within the Board over time.
- Identify and recruit Board talent. Our mission is not to simply hire the best person for the slot. It is to first create a vision for the proper diversification of skills and perspectives needed by the board a problem solving unit over the next 3-5 years. We approach Board talent like college admissions officers more than traditional executive recruiters.
- Board self evaluation using the National Association of Corporate Directors standards.
- Customized Board education programs.
- Assistance in helping Boards review their ISS CGQ rankings and to help drive the improvement plan.

Google ranks Boardoptions.com #1 on the Internet for Board Talent.

ABOUT THE SAYWER SCHOOL OF BUSINESS AT SUFFOLK UNIVERSITY

The Sawyer Business School is accredited in business and accounting by [AACSB International](#) -- the Association to Advance the Collegiate Schools of Business. This distinction is shared by less than 10% of the world's business schools. Campuses are located in Boston, Madrid, and Dakar.

For more information:

Laurence J. Stybel, Ed.D.
BOARD OPTIONS, INC.
60 State Street, s. 700
Boston, MA 02109
Tel. 617 594 7627
lstybel@boardoptions.com
www.boardoptions.com
lstybel@boardoptions.com