

CORPORATE GOVERNANCE COMMUNICATION AND VALUE CREATION

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Abstract

Corporate scandals and the ongoing economic crisis have heightened academic and practitioner interest into corporate governance. Resulting corporate governance codes and related legislative developments place increasing emphasis on what companies should communicate on their governance arrangements. But whether and how corporate governance communications add value to companies remains a subject of debate. To shed light on these questions, we review two hitherto unconnected and parallel literatures from accounting and finance, and corporate communications research respectively. We develop a multi-dimensional model of corporate governance communications to explain the contingent conditions that can lead to value creation.

Keywords: Value Creation; Corporate Governance; Corporate Scandals

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1 Introduction

In the wake of the corporate scandals of the 1990s and 2000s, corporate governance systems, structures and processes have been the subject of much academic research and practitioner interest (Daily *et al.* 2003; Huse, 2005, Shleifer & Vishny, 1997). In an attempt to improve 'good governance', corporate governance codes have been introduced worldwide (Aguilera and Cuervo-Cazzura, 2004). Regardless of their national specificities, the underpinning philosophy is that corporate transparency and associated corporate disclosures are key components of 'good governance' (OECD, 2004). Subsequently, we have witnessed ever increasing volumes of corporate communications, from mandated disclosures on financial reporting and compliance with corporate governance codes, to voluntary disclosures on strategy developments or Corporate Social Responsibility (CSR).

These developments raise several issues for scholars. First, the underlying assumption that more communication on corporate governance always produces better outcomes for firms and shareholder is questionable (Hermalin and Weisbach, 2012). Agency theory scholars have argued that through reduced information asymmetries, corporate governance communications can lower costs of capital and produce more accurate analyst forecasts (Healy and Palepu, 2001). These advantages are tempered, however, by the costs such communications generate (Craven and Marston, 1999), the adverse effects of

disclosing commercially sensitive information (Hayes and Lundholm, 2006), and the possibility of additional agency costs such as increased executive compensation (Hermalin and Weisbach, 2012). The second question that arises is *how* such corporate disclosures are best attained. The literature shows that there is a wide diversity of content and presentation not only in annual reports (Beattie *et al.* 2008; Frownfelter-Lohrke and Fulkerson, 2001; Thomas, 1997), but also in other media such as the internet (Bollen *et al.*, 2006; Craven and Marston, 1999). Moreover, recent developments in social media platforms are changing at a fundamental level how companies communicate with their stakeholders (Crawford, 2009).

Answering these questions also has implications for practice. In an age characterised by vast and almost instantaneous information flows, the failure to deliver the right information at the right time can negatively affect investor relations (Deller *et al.*, 1999) and damage reputation (Argenti and Haley, 2006). Hence, company websites and preliminary announcements are assuming an ever greater importance as vehicles for corporate communications. In addition to the choice of media, there is the question of how content is best structured, narrated and displayed.

Ultimately, the underlying question is whether, and if yes how, corporate communications on governance add value to the organisation, its shareholders and/or other stakeholders. To this end,

we review and synthesise the extant literature on communicating corporate governance and value creation. By bringing together two hitherto unconnected literature streams, from finance/accounting and corporate communications respectively, we aim to provide new insights into corporate governance communications. Following a brief summary of concepts used to describe the outcomes of corporate governance, we outline the theoretical basis for linking corporate communications and value creation, and discuss the extent to which there is supporting empirical evidence. We finish by distilling a number of ‘best practice’ recommendations for communicating corporate governance.

2 Corporate Governance and value creation

In order to understand whether and how communicating corporate governance contributes to value creation, it is perhaps important to first consider the scope of the concept of corporate governance, and associated with these conceptual issues the outcomes of corporate governance.

Agency theory continues to be the dominant theoretical perspective in corporate governance research (Daily et al., 2003; Gabriellsson and Huse, 2004), and one which underpins many definitions such as those by Shleifer and Vishny (1997) or Denis and McConnell (2003). In agency theory, the interests of managers and shareholders are essentially divergent and corporate governance is defined in terms of the mechanisms that ensure managers act in the best interest of the corporations’ principals (shareholders) and maximise shareholder value (see also section 3.1. below). Other definitions, such as those by Huse (2007) and the OECD (2004), adopt a broader perspective by defining corporate governance in terms of directing companies towards value creation, which in turn involves interactions, systems and processes between a wider group of firms’ actors and/or stakeholders. Despite the differences in narrow shareholder versus broader stakeholder conceptualisations of corporate governance, these definitions share common ground insofar as they view some sort of value creation to be an outcome of corporate governance. How such value creation is defined, who benefits from it, and how we can measure the outcomes, are questions which are addressed below.

Table 1. Corporate governance outcomes: definitions and measurements

Concepts used to describe governance outcomes	Beneficiary	Measurements
<i>Shareholder value</i> (Epstein and Roy, 2004; Pitman, 2003; Zahra and Pearce, 1989)	Shareholders	Stock price, return on investment, dividend growth, total return to investors, Sustained value growth
<i>Firm value</i> (Huse, 2007)	Firm and its stakeholders (including, but not exclusive to, shareholders)	Porterian value chain analysis (resource acquisition, operation, innovation, resource allocation, implementation, distribution)
<i>Firm performance:</i> Financial/economic performance (Bushman and Smith, 2003; Zahra and Pearce, 1989) Non-financial performance (Hillman, Keim, and Luce, 2001)	Financial investors Employees, customers, environment, community	Return on assets, return on equity, return on sales, dividend per share, net profit margin Employee well-being, workplace safety, customer satisfaction, product development, environmental performance, community relations

As is shown in table 1, the literature uses slightly different concepts to describe and measure the outcomes of corporate governance. Most commonly, these outcomes of governance are seen in economic/financial benefits accruing to shareholders of corporations (typically described in terms of performance and/or shareholder value), with financial accounting metrics used to quantify these benefits. However, the emphasis on financial economic returns

to shareholders has increasingly been critiqued. First, accounting metrics are in the main backward-looking, or lagging, performance measures. Thus, they can be a poor basis on which to predict future performance and/or devise incentive systems for management (Aerts et al., 2007; Epstein and Roy, 2004). Second, several accounting measures have been critiqued for being open to manipulation and distortion, and for lacking standardisation in international accounting

(Huse, 2007). Thus, companies such as Enron or Parmalat were able to mask poor performance over a period of time (Benston, 2006). Third, these outcomes and measures are based on the acceptance of the primacy of shareholders over other stakeholders, a view that has increasingly been challenged as being harmful to corporations and investors (Stout, 2012), or at least inadequately capturing the corporate objectives (Freeman, et al., 2004). Fourth, the focus is of these financial/economic outcomes is on tangible, and often easy to capture and quantify, measures. Increasingly, the literature points to the need to evaluate more intangible outcomes and associated qualitative variables such as reputation, corporate image or corporate identity as proxies for performance (Argenti and Druckenmiller, 2004; Cravens *et al.*, 2003; Dolphin, 2004; Forman and Argenti, 2005; Kim *et al.*, 2007; Melewar, 2003). In summary, a narrow focus on economic/ financial returns has various shortcomings as it captures value creation incompletely and sometimes misleadingly.

Huse (2007) has argued for a using a more comprehensive framework for defining and measuring value creation. In the framework, he distinguishes between internal value creation, i.e. strategies, processes and policies that enhance the value chain internal to the organisation, and external value creation, i.e. firm-specific outcomes that are of value to external stakeholders. Huse (2007) further separates value creation that can purely be understood and measured in economic terms, and value creation that has a social dimension. The resulting categories, however, are not mutually exclusive. For example, there is a wealth of evidence that links internal value creation processes to financial performance (Zahra *et al.*, 2000), or social value creation with economic performance (Orlitzky and Benjamin, 2001; Orlitzky *et al.*, 2003). As Porter noted already in 1985, companies which are sustainably successful pay attention to value creation along the entire business value chain, not only the final value dispersion to shareholders (Huse, 2007; Porter, 1985). Thus, value creation should not be viewed solely as a short-term economic risk/return calculation, but a broader spectrum of internal and external processes, strategies and behaviours (including tangibles and intangibles) that sustainably promote successful business growth in the long term.

That leaves the questions of how shareholders and other stakeholders learn about organisations' value and corporate governance, and this is where corporate communications plays a pivotal role. The literature uses a number of terms for describing the means and processes by which companies

communicate with their stakeholders, and these are summarised in table 2.

Most commonly, the literature uses the terms 'disclosure', and to some extent also 'financial reporting' to describe the mechanisms by which companies communicate with outside parties. Such disclosures are divided into mandatory ones stipulated by law, which in the main relate to the production, publication and dissemination of company accounts and corporate governance arrangements, and voluntary ones. The latter have mainly been described as the range of non-financial information disclosures that companies make in order to provide investors with lead indicators on future performance (Aerts *et al.*, 2007) and/or to supplement mandatory accounting disclosures in order to contextualise and explain such accounting data to investors (Healy and Palepu, 1993).

The terms 'disclosure' and 'financial reporting' are found primarily in the economics, finance and accounting literature, and implicitly or explicitly denote a one-way communication from companies to current or potential investors. Scholars with a background in communication studies tend to use terms such as 'corporate communications', 'investor relations' and/or 'transparency' (Argenti, 2006a; Parum, 2006). Whilst these concepts still include the notion of information dissemination to investors, they have a broader meaning than 'disclosures' as they typically encapsulate how and why companies communicate with external actors (Argenti, 2006b). Thus, the study of corporate communications also pays attention to issues such as channels of communication (print versus online), communication quality (credibility, timeliness, presentation, accuracy etc.), communication context (development of media, market for corporate communications), and communication processes (directionality, scope for dialogue with investors) as indicators of how effective communications are (Parum, 2005). Additionally, corporate communications are affected by prevalent corporate values and fit (to varying degrees) into the broader strategic context of the organisation (Argenti, 2006b). Therefore, corporate culture and the specific strategic context are important variables that explain how and why companies communicate.

Disclosures, or the mechanisms for providing information to investors, are thus best viewed as a sub-set or element of corporate communications. Why companies engage in corporate communications, and how communicating corporate governance may affect firm value, are questions that we seek to address in the following section.

Table 2. Summary of terms used to describe communications between companies and stakeholders

Term/concept used	Author(s)	Description/ notes
<i>Corporate Disclosure (financial/non-financial; compulsory/voluntary)</i>	Aerts <i>et al.</i> (2007); Aksu and Kosedag (2006); Beattie <i>et al.</i> (2008); Collett and Dedman (2010); Craven and Marston (1999); Forker (1992); Gibbins <i>et al.</i> (1990); Healy and Palepu (1993, 2001)	Mechanisms for managers' communication with outside stakeholders; includes mandatory accounting disclosures and voluntary non-financial disclosures (e.g. CSR disclosures, information on business strategy, product development, client profiles)
<i>Financial Reporting</i>	Melis (2004)	"The term financial reporting incorporates not only financial statements, but also includes other means of communicating financial and non-financial information, e.g. management forecasts, stock exchange documents etc." (Melis, 2004: 32)
<i>Corporate communications</i>	Argenti (2006a, 2006b); Forman and Argenti (2005); Parum (2006); Subramanian <i>et al.</i> (1993)	Corporate communications can be seen as: a/ an organisational function (like marketing) b/ a channel of communications (print or electronic) c/ a communication process (style of communication) d/ an attitude or set of beliefs (inherent values communicated) (Argenti 2006b) Overall, seen as a structured dialogue (Parum, 2005) between companies and their shareholders and other stakeholders; includes both external communications (company reports, external websites, press releases and external ratings) and internal communications (intranets, employee communications)
<i>Investor relations</i>	Bollen <i>et al.</i> (2006); Deller <i>et al.</i> (1999)	"...the strategy of corporations with regard to communication targeting current and potential investors." (Deller <i>et al.</i> , 1999:352): included corporate reports, company website, interim reports, AGM, press conferences, round tables, 1:1 discussions and phone calls
<i>Transparency</i>	Bushman and Smith (2003)	Includes types of disclosures (financial accounting, governance); quality of disclosure (timeliness, credibility, availability in English); information dissemination (degree to which information is spread via media); and private information acquisition and reporting (analyst following, information communications, institutional investors)

3 Communication of corporate governance and value creation: theoretical underpinning and empirical evidence

There are two broad strands of literature that investigate the link between corporate governance communications and value creation. One strand has its origins in economics, accounting and finance and focuses primarily on the effects of corporate disclosures on capital markets (Leuz and Verrecchia, 2000). The second area is in the comparatively more recent field of corporate communications and seeks to establish the factors that influence effective corporate communications, and the extent to which such

communications, via effects on reputation and company image, contribute to corporate objectives. The following sections present a review and summary of these different approaches to theorising about, and measuring, corporate communications and value creation.

3.1 Economic-financial perspectives on corporate governance communications

Within the economics and finance literature, there are three theoretical strands which seek to explain why corporations make disclosures to investors and other stakeholders, and what the effects of such disclosures are on capital markets and the economic performance

of the corporation. The first strand, *agency theory*, dates back to the seminal work by Berle and Means (1933) and was later developed by Jensen and Meckling (1976). Based on the premise that in modern corporations ownership and management are separated, and that individuals seek to maximise their own utility, the interests of internal managers and outside shareholders diverge. In other words, managers may seek to pursue their own objectives such as maximising their earnings which could be to the detriment of shareholders. Moreover, managers, by virtue of being involved in the day-to-day running of the company, have superior information about the company's performance compared to outside investors. These information asymmetries, in combination with the assumed self-seeking interests of managers, mean that shareholders incur costs by having to monitor and control managers. Corporate governance, in the tradition of agency theory, is about mechanisms such as boards of directors, or the market for corporate control, which serve to align the interests of internal managers with those of the shareholders (Eisenhardt, 1989).

In the context of agency theory, corporate disclosure and communications are a key instrument for remedying one of the underlying problems to agency relations: information asymmetries. By providing existing and potential investors with financial and non-financial information about current firm performance, and forecasts on future performance trends, two effects are achieved. First, high quality information allows investors to more accurately value companies and this in turn improves the functioning of capital markets. If there is little or no detailed and reliable information about companies, a 'market for lemons' (Akerlof 1970) exists whereby good companies or projects may be under-valued and poorly performing companies or risky projects over-valued. In the absence of information on performance, capital markets would tend to converge to an average, i.e. value both good and poor performers at an average, meaning that good performers pay a higher premium for raising capital, and conversely poor performers a lower premium. Thus, one effect of detailed and accurate disclosure is a better functioning capital market which in turn will lower the costs of raising capital for companies, will lead to increased liquidity in markets (as there is less risk for investors of adversely selecting a poor investment project), and lead to more accurate analysts' forecasts (Aksu and Kosedag, 2006; Bushman and Smith, 2001; Craven and Marston, 1999; Healy *et al.*, 1999; Healy and Palepu, 1993, 2001).

The second effect of high levels of quality disclosure relates to the agency problem once the investment has taken place (e.g. shares have been bought). Assuming that managers are motivated by self-interest, there is a danger that managers may not use these funds to maximise returns to shareholders or misuse funds for personal gain. Disclosures may help

shareholders and boards to better monitor and control the actions of management, thus reducing the likelihood that managers expropriate wealth (Bushman and Smith, 2001, 2003; Healy and Palepu, 2001). But there may also be a downside to information disclosure within an agency-theoretic framework. Hermalin and Weisbach (2012) theoretically demonstrate that disclosures improve principals' decision-making, but at a certain point of disclosure additional agency costs can occur in the form of higher executive compensation. Overall, the argument from agency theory scholars is that the narrowing of information asymmetries between shareholders and managers is the basis on which investors are able to better protect their investment from potential managerial abuse.

Whilst agency theory focuses primarily on the effects of improved information on investment decisions and capital markets, a second related theoretical strand investigates the way in which companies strategically use disclosures to enhance firm value. *Signalling theory* argues that companies use corporate communications to send signals to investors about their profile and high quality (Craven and Marston, 1999). For example, by using well developed websites, companies communicate their competencies in using information technology to investors. Or by disclosing information on the board of directors, companies may seek to signal the quality, reputation and integrity of their upper echelons (Bushman and Smith, 2003). The signals are therefore more about communicating intangible qualities or values, and investors and analysts receiving these signals may in turn value companies more highly. Thus, good communications and firm performance are seen as creating a positive feedback loop.

These two theoretical approaches, *agency* and *signalling theory*, by and large assume that greater and better disclosures are ultimately beneficial to firm value. The third strand in the economics and finance literature is a multi-theoretic one and is based on a *cost/benefit approach*. Scholars from this tradition argue that companies calculate and weigh up the costs and benefits of making disclosures, especially voluntary, non-financial disclosures (Aerts *et al.*, 2007; Craven and Marston, 1999; Deller *et al.*, 1999). Benefits of disclosures in terms of shareholder investment decisions and risk assessment are derived from agency theory, whereas signalling theory points towards the benefits in terms of intangibles such as reputation or image. Yet there also costs. Information needs to be collected, collated, processed and professionally presented. Theoretically, large firms are more likely to be able to absorb these costs than smaller firms (Hermalin and Weisbach, 2012). Furthermore, if information is made publicly available in annual reports or websites, it is not only investors or analysts who are able to access that information but also competitors, which may result in a trade-off between capital market benefits and the costs of

aiding competitors (Hayes and Lundholm, 1996). The resource-based view of the firm suggests that the more intangible resources a firm possesses, and the more difficult these are to replicate, the more competitive the firm is likely to be in the long run (Barney, 1991, 2001; Barney, *et al.* 2001). If companies disclose details on, for example, their product development, strategic posture or organisational culture, it could place them at a competitive disadvantage if rivals are able to use that information. Companies therefore have to find the right balance between satisfying information needs of investors and analysts, and protecting commercially sensitive information from rivals.

Empirical research on the link between corporate communications and firm value tends to show some support for the positive effects of better disclosures, albeit under some important country- and firm-level contingencies. Specifically, the literature reveals that:

- ✓ Increasing levels of disclosure have benefits in terms of investor's share valuations, stock liquidity, cost of capital and share performance (Healy *et al.*, 1999; Healy and Palepu, 2001; Leuz and Verrecchia, 2000).

- ✓ Levels of disclosure are related to analysts' following and the range and accuracy of analysts' forecasts (Aerts *et al.*, 2007; Healy *et al.*, 1999; Healy and Palepu, 2001).

- ✓ Companies in countries with well-developed capital markets (US, UK) show greater levels of communication, both paper and web-based (Aerts *et al.*, 2007; Bollen *et al.*, 2006; Deller *et al.*, 1999).

- ✓ Larger companies have higher levels and higher quality communication than small ones (Bollen *et al.*, 2006; Craven and Marston, 1999).

- ✓ There is little research and non-conclusive evidence of signalling effects (Bollen *et al.*, 2006; Dolphin, 2004).

The above findings, however, have a number of limitations. First, the majority of studies are located in the U.S. context which is characterised by highly developed capital markets and an information-rich environment (Deller *et al.*, 1999; Leuz and Verrecchia, 2000). Second, there are methodological challenges in disentangling the cause-effect relationship between disclosures and market outcomes, and whether corporate governance acts as an antecedent or consequence to that relationship (Collett and Dedman, 2010). Finally, these studies tend to tell us about market consequences of disclosures but relatively little about broader aspects of corporate communication. In order to better understand dimensions of communications that may influence their impact, in the following part we will turn our attention to the communications literature.

3.2 Corporate Communications

Compared to the economics/finance literature, corporate communications literature is a more recent domain. Broadly speaking, scholars here have sought to understand how and under what conditions communications evolve, and what makes communications effective. As such, the literature has a much stronger focus on the less tangible aspects and effects of communications, but fits better into the broader conceptualisation of value creation as outlined by Huse (2007) discussed above.

Corporate communications is a very fast-moving area and has seen many changes which affect the way in which companies communicate with shareholders and other stakeholders (Kaplan and Haenlein, 2010). Several scholars have argued that the changes brought about by the digital age create challenges as well as opportunities for corporate communications, these are summarised in table 3.

Table 3. Changes, challenges and opportunities in corporate communications

Changes and challenges	Opportunities
<ul style="list-style-type: none"> • Less control by companies over information and communication • All stakeholders have easier and cheaper access to information • Communications are more dynamic and less static (less opportunity for 'prepare and tell') • Possibility that corporate vision and values get challenged by stakeholder groups (employees, environmental groups) leading to damage of corporate image • Maintaining coherence across multiple media channels 	<ul style="list-style-type: none"> • Greater ability to use technology to measure impact of communications • Greater scope for visualisation and inter-activity • Value of listening to stakeholder groups • Increased effectiveness of communications through higher degree of integration • Ability to communicate quicker and to more diverse audiences

Source: Argenti (2006b), Crawford (2009), Kaplan and Haenlein (2010)

Given these challenges and opportunities, the issue arises as to what factors affect the effectiveness of corporate communications. Scholars have used

different concepts to describe and measure the effectiveness of communications. The most widely used concepts in the literature include *reputation*

(Argenti and Druckenmiller, 2004; Cravens *et al.*, 2003; Dolphin, 2004; Forman and Argenti, 2005; Kim *et al.*, 2007; Melewar, 2003), *credibility* (Jones, 2002), *brand value* (Argenti and Druckenmiller, 2004; Forman and Argenti, 2005) and *corporate identity* (Argenti and Druckenmiller, 2004; Melewar, 2003; Parum, 2006). What we have seen in the literature and in practice is an increasing move away from counting outputs of communications (such as press or analysts reports) towards measuring the value created by corporate communications.

Despite the differences in how the literature describes and measures the value created by communications, there is broad agreement on the influences, or factors affecting this value creation. In a survey of corporate governance communications via websites of international companies, Jones (2002) and Deller *et al.* (1999) found that there were five variables influencing the effectiveness of communications:

1. *Completeness of information* (as information is easily accessible by stakeholders, any omissions or errors are easily identified)
2. *Verifiability of communications* (more believable if there are objective measurements,

substantiation of statement and/or independent verification)

3. *Familiarity* (investors perceive communications to be of better quality of they are in a format that they are familiar with)

4. *Responsiveness* (measure of how serious companies are about communicating with investors and other stakeholders, i.e. are contact details easy to locate, chat settings)

5. *Ease of use* (the experience of finding and navigating the website can influence how company is perceived, i.e. difficult to navigate websites can create impression that company does not want to communicate or is hiding things)

Whilst the above findings relate to an analysis of electronic communications, which themselves account for an increasing volume of corporate communications and analysts' traffic, similar dimensions have also been identified in print media (Beattie *et al.*, 2008; Subramanian *et al.*, 1993). In a detailed longitudinal survey about changes in annual reports in the UK, Beattie *et al.* (2008) identified the following trends:

Table 4. Presentational changes in UK Annual Reports 1965-2004

<p>Annual reports have increased from an average of 26 pages in 1965 to 75 pages in 2004. There has been a 186% increase in regulatory material presented, and a 190% increase in voluntary disclosures.</p> <p>The amount of narrative information increased by 375%, pictorial information increased by 100%.</p> <p>Financial statements are no longer included in the main body of Annual Reports but are presented in the appendices.</p> <p>Design sophistication has increased sharply: 78% of companies in 2004 displayed prominent corporate logos at the front page (only 28% in 1965), and 72% used external design consultants (only 12% in 1965).</p> <p>Graph usage has increased from 79% to 99%, but mainly showing benchmarked performance in non-key performance areas such as CSR. Graph usage for key financial variables has declined slightly.</p> <p>There have been substantial changes in content with particular increases in corporate governance communications. In 2004, 98% of companies included a remuneration report, 89% provided information on their board, 85% included a dedicated corporate governance report, 65% presented shareholder information, 56% included a CEO statement, 51% had a dedicated Corporate Social Responsibility (CSR) section and 50% provided a statement of directors' responsibilities.</p> <p>Material distortion of graphs has increased sharply, especially as a way of impression-managing poor performance</p> <p>The use of visual images that are 'glamorous, kaleidoscopic and entertaining' (p.188) is increasing, strongly influenced by media representations such as television.</p>

Source: derived from Beattie *et al.*, 2008

What the findings summarised in table 4 suggest is that companies are increasingly professionalising annual reporting, and that information is no longer simply presented but increasingly contextualised and

managed. To some extent, these changes are driven by regulatory pressures or corporate governance codes. For example, Beattie *et al.* (2008) assert that the increase in graph distortion may well be related to

the fact that as companies can no longer avoid reporting, they resort to presentational formats that put a positive gloss on areas of poor performance. This proposition is further supported by studies into the use of linguistic devices in annual reports. Subramanian *et al.* (1993) found a statistically significant difference in readability of annual reports between well and poor-performing companies. They furthermore noted that for poor performers the use of passive voice and sentence length increases substantially, and that there is a tendency to use de-emphasising techniques, for example, “favourable loss experience for the corporation” (Subramanian *et al.*, 1993, p.58. Thomas (1997) also found a correlation between the use of passive sentence structures and declining performance, and noted a tendency to use more factual language when performance worsened as a way of shifting responsibility from human agents (i.e. internal managers) to outside, non-human factors.

But are well-presented, interactive, easy-to-use and complete reports or websites sufficient in creating effective communications? A small number of articles suggest that unless there is a link between corporate communications and firm values and strategy, communications remain hollow, disconnected and ultimately have little impact on value creation. Forman and Argenti (2005) conducted a qualitative study into five large and internationally successful corporations (Accenture, Dell, FedEx, Johnson and Johnson, and Sears) and found that there were strong commonalities in the way which these companies deployed communications in order to create value via firm image and reputation:

1) Close alignment between the corporate communications function and implementation of strategy: regular involvement of communication professionals in strategy development and implementation, especially during times of strategic organisational change; corporate communications used to facilitate stakeholder buy-in into strategy

2) Direct reporting of corporate communications to CEO: communication executives had “seat at the CEO’s table” (p.252) and were often directly line-managed by CEO; this conferred authority and legitimacy on communication function (see also Crawford, 2009)

3) Focus of communications on brand and reputation: recognition of the value of external ratings and the benefits of positive media attention for corporate reputation (see also (Argenti and Druckenmiller, 2004; Jones, 2002)

4) Alignment of internal with external communications: recognition of the importance of having integrated and consistent communications (see also Jones, 2002 and Argenti and Haley, 2006); buy-in from employees into strategy especially important in promoting consistent image

5) Use of IT to enhance communications: sends important signals to investors and stakeholders and

can be important means of conveying and managing impressions of company (see also Craven and Marston, 1999 and Jones, 2002)

6) Corporate communications as art and science: important to use sophisticated performance measures to quantify results of communications but need to balance that with recognition that there are also intangible aspects such as the need to create the right impression (Forman and Argenti, 2005)

Although these conclusions are intuitively sensible, and backed up with qualitative data from the five case study companies, they do not provide substantive empirical evidence of the link, or the extent to which communications create firm value. In a methodologically more sophisticated paper, Kim *et al.* (2007) test for the link between different types of communications and profitability of firms. They developed two constructs by which companies could be categorised in terms of their communications. *Symbolic management* companies are those where corporate communications are strategically used to create a positive image among investors and the media. Those companies would prioritise resources in public relations and seek to manage impressions through positive signalling. *Behavioural management* companies, on the other hand, are those that align their corporate actions with the message from corporate communications. These behavioural management companies would seek to change their business actions and behaviours, and communicate that, rather than ‘focusing on image-moulding rhetoric’ (Kim *et al.*, 2007, p.78). The findings of their research suggest that symbolic management has only a weak correlation to profitability, whereas behavioural management creates a positive performance reputation which is strongly correlated to corporate profitability. In other words, using corporate communications as window-dressing may create short-term benefits for companies, but it is only when corporate actions and behaviours are consistently aligned with communications that there is a sustainable impact on firm value.

4 Best practice in corporate governance communications

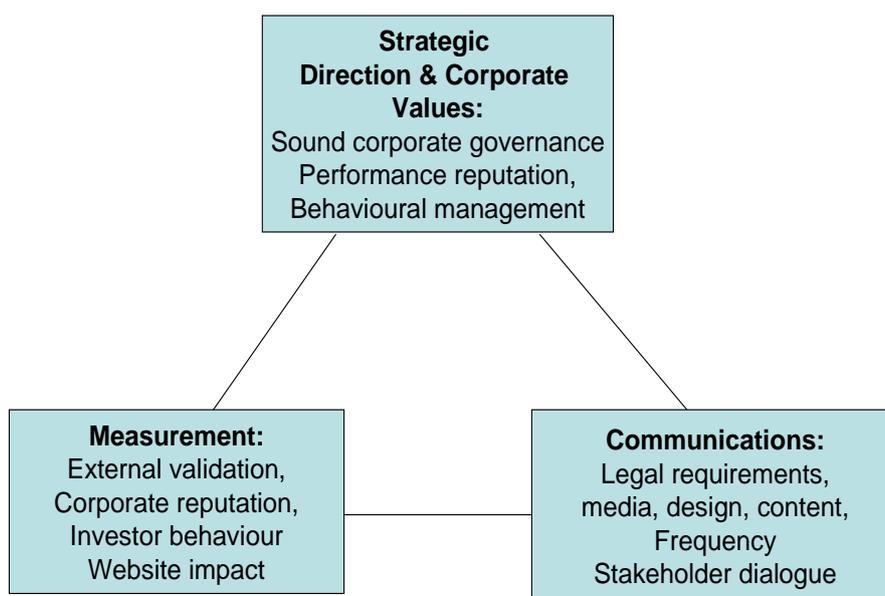
Drawing together the literature streams discussed in section 3, we propose that corporate governance communications is not solely about what and how much is communicated, rather that there are multiple dimensions of ‘best practice’. Research on corporate disclosures and communications makes reference to a concept called ‘normalisation processes’ (Beattie *et al.*, 2008). Essentially, a few high-profile companies tend to introduce innovations in their corporate communications, and this is followed by more widely-spread adoption until finally even laggards follow suit and the original innovation becomes the norm. Often a summary of ‘best practice’ is in fact happening at an advanced point of normalisation

when many companies have already adopted the practice and, more importantly, when there is evidence that it actually produces benefits for companies and their shareholders. Moreover, as resource-based theory tells us, if a practice or process is easy to imitate or copy by rivals, any competitive advantage deriving from it is only fleeting one and not sustainable in the long run (Barney, 2001). These

caveats should be born in mind when developing and/or applying any best practice recommendations.

There are three inter-related dimensions that help us understand how corporate governance communications can create firm value, presented diagrammatically in Figure 1.

Figure 1. Dimensions of corporate governance communications



Communications need to be underpinned first and foremost by sound corporate strategies and organisational values (Forman and Argenti, 2005). Corporate governance, as previously noted, can be understood as a set of mechanisms and interactions that direct companies towards value creation and is thus intrinsically linked to organisations' strategic direction and values. Essentially, companies and their boards have to continuously focus on their value chain (Huse, 2007). Having clarity on one's overall strategy then links to the second dimension - the context and content of corporate communications. As previously discussed, companies need to meet minimum standards of communications required by law. This mandatory disclosure provides investors with a baseline upon which to base investment decisions (Eisenhardt, 1989; Healy *et al.*, 1999). However, in order to allow for more accurate investment evaluations by market participants, and to support the creation of more intangible value elements such as corporate reputation, companies need make additional, voluntary disclosures and pay attention to what they communicate, how, with whom and how often (Aksu and Kosedag, 2006; Bushman and Smith, 2003; Healy *et al.*, 1999; Healy and Palepu, 2001). In a summary of two reports by Deloitte, a professional management accounting publication (Anon, 1996) noted that most companies in the past under-exploited opportunities for communication because of three

factors: 1) inadequate planning of their narrative or story they wanted to tell, 2) failure to deliver the right information at the right time and 3) inadequate assessment of performance against market expectations and benchmarks. The latter leads into the third best practice dimension – measurement. As Zairi (1994) notes “Quality improvement without measurement is like hunting ducks at midnight without a moon – lots of squawking and shooting with only random results and with a high probability of damage.” (p.4). Again, there is no single formula or methodology for measuring the value creation of governance communications, however, there are a range of tools and techniques that companies can deploy:

1. External validation/benchmarks: There is strong evidence that measurements, indices or reports that are independently compiled and published have a strong impact on investor and consumer confidence (Aerts *et al.*, 2007; Bronn, 2004; Jones, 2002; Pucheta-Martinez and de Fuentes, 2007). Furthermore, such independent ratings also provide a good yardstick for companies measuring their progress against competitors. Thus, pro-actively seeking out and participating in external surveys and indices creates real business advantages.

2. Exploiting technology: Technological advancements have created significant opportunities for measuring the impact of communications

(Argenti, 2006b). For example, technology is now available to assess the impact and use of websites, including blog tracking and analysis (Thelwall and Stuart, 2007).

3. Measuring intangibles: Academic researchers have for some time now developed models and metrics for measuring intangibles such as corporate identity (Melewar, 2003), investor behaviour (Healy and Palepu, 1993) or corporate reputation (Money and Hillenbrand, 2006; Rindova *et al.*, 2005). Making better use of this academic research can enable companies to measure the outcomes of corporate strategies and corporate communications in a more rigorous and informative fashion.

All three elements described above – strategy and governance, communications and measurements – form a mutually re-enforcing loop. Although there is no magic recipe, evidence from the literature and practice suggests that internationally successful companies not only pay attention to all three elements but are also innovative and sophisticated in their application of these concepts.

5 Conclusion

In this article, we set out to investigate the link between communicating corporate governance and firm value. Scholars from different subject and methodological backgrounds have provided theoretical arguments and empirical evidence on why and how communicating corporate governance has an impact on firm value. That impact is on the hand via improvements in capital markets (i.e. share prices, cost of capital, liquidity) and on the other hand via improvements to more intangible outcomes such as corporate reputation and image. The literature furthermore provides clues about recent trends in communications and the factors that affect the effectiveness and credibility of communications. Based on these hitherto separate literature streams, we have synthesised dimensions of corporate governance communications based on firm strategy and values, communications and measurements. For companies that face increasing challenges arising from developments in digital and social media, these dimensions can inform a more holistic and integrated approach to corporate governance communications. Our review also identifies a number of questions and gaps in our knowledge. To date, too little systematic attention has been paid to contingencies that affect the outcomes of corporate governance communications. At the macro-level, much of the empirical research has been carried out in the United States, and we need to have more evidence of capital market or reputation impacts elsewhere in the world (Leuz and Verrecchia, 2000). At the firm level, we need to better understand variances in the value-added of communications/disclosures for specific companies or sectors (Craven and Marston, 1999). Moreover, as

communication media continuously advance and develop (Kaplan and Haenlein, 2010), we need to better understand how interactivity between different actors within and outside the organisation shapes the outcomes of corporate governance communications.

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