2. Introduction

This is a supplement to IFC’s Toolkit 2: Developing Corporate Governance Codes of Best Practice. The focus of Toolkit 2 is the development of codes of corporate governance. This supplement focuses narrowly on how to use scorecards to measure the observance and implementation of such codes. It does not cover the full panoply of governance assessment tools.

One of the key values of scorecards is that they raise awareness of good standards and practices at different levels of the market. Scorecards are part of a long-term, iterative process to improve the governance culture within a country. Clearly, scorecards are not the only means to achieve this goal. Nor are they a panacea. A variety of mechanisms may enhance governance practices and standards in a market and among companies, and it is not the purpose of this publication to cover every possible mechanism.

This supplement is not intended to be a full manuscript of all the available tools or assessment techniques but more a guidance on various possible uses and applications of scorecards. As with all IFC knowledge management tools, the supplement cannot foresee all situations and eventualities. It is, however, intended to cover most of the issues that might confront any institution, regulator, stock exchange, and so on, that has in mind to develop a scorecard and to provide some practical guidance on how to approach those issues.

What is the purpose of this supplement?
This supplement provides practical guidance and a step-by-step approach on how to develop a corporate governance scorecard. It also presents different approaches to scorings based on the experience of different scorecard users in different countries. The supplement also shows how scorecards are adapted to local circumstances and the local corporate governance framework.

Scorecards generate numerical scores. In Section 4.5, “Summarize and present the results,” the supplement shows a variety of useful information that can be created from such scorings. In Section 6, “Building on scorecards,” it also presents other potential uses of scorecards, such as the basis for stock exchange indexes or tiers.

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1 Toolkit 2: Developing Corporate Governance Codes of Best Practice can be found here: http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/global+corporate+governance+forum/publications/toolkits+and+manuals/toolkit2_codes_of_best_practice.
2 A corporate governance code defines best practice in governance among companies. Most countries now have a corporate governance code.
3 The supplement does not go into detail regarding corporate governance ratings, indexes, or tiers. For more information on these, see D. Grimminger and P. Di Bendetta, Raising the Bar on Corporate Governance: A Study of Eight Stock Exchange Indices (World Bank and IFC, 2013).
What is a scorecard?
A scorecard is a quantitative tool to measure the level of observance of a code and/or a standard of corporate governance. Scorecards compare governance practices to a benchmark. Typically the benchmark is a national code of corporate governance or an international code or standard. Scorecards are not used principally to measure regulatory compliance. Rather, scorecards measure the observance of a voluntary code of best practice. Scorecards are used to assess a company’s governance practices, show progress over time, and compare different companies and even groups of companies within or across countries.

Scorecards are tools to measure and motivate
“A corporate governance scorecard is a measure to encourage and motivate adherence to good corporate governance practices. It can be usefully deployed by regulators to evaluate market response to a corporate governance code and its recommendations, while companies might use it to guide their adherence to the recommended practices contained in a corporate governance code.”

- Philip Armstrong, Senior Advisor Corporate Governance, IFC

The original source of inspiration for many scorecards was the one developed by the German Financial Analysis and Asset Management Association (DVFA). The purpose of the DVFA scorecard was to provide financial analysts and investors with a practical tool to evaluate the governance of listed German companies. In addition, the DVFA scorecard served as a tool to measure the level of compliance of listed companies with the German Corporate Governance Code.

What are the broad goals of scorecards?
Scorecards have goals at both the market level and the company level.

Market-level goals
At the market level, the overarching goal is the development of safer and more efficient capital markets. One way to strengthen capital markets is to improve the implementation of the governance framework. Governance codes and standards are an important part of this framework. Scorecards encourage implementation of codes and standards by benchmarking companies and countries over time. Scorecards set expectation levels, generate incentives for reform, help direct change, and can set in motion a process of continual improvement.

Company-level goals
At the company level these goals begin with providing companies with a powerful analytical tool. Scorecards are a useful basis for companies to start an analysis of their governance practices. Scorecards help identify shortcomings against locally defined standards and/or generally accepted international standards of good practice. The findings of a scorecard can, in turn, be used to help the company develop a corporate governance improvement plan. The ultimate outcome should be better operational performance and lower risk as a result of better governance practices.

Scorecards encourage a better governance culture and a better business climate
“Scorecards can be useful in countries wishing to implement best corporate governance practices. Scorecards can support the efforts of the government and the business community to further strengthen the country’s business climate.”

- Christian Strenger, Academic Director, Center for Corporate Governance HHL Leipzig Graduate School of Management, Deputy Chairman PSAG

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4 For a discussion of the different benchmarks, see Section 4.3.2, “Choose the benchmark,” of this supplement.
5 For more information on DVFA, see http://www.dvfa.de/home/.
6 The Deutscher Corporate Governance Kodex is available at http://www.corporate-governance-code.de/.
It has been shown repeatedly that scorecards educate companies on good governance practices and on local codes. Iterative scorecard assessments can create a virtuous cycle by which companies assess and reform and ratchet up their governance practices.

The specific outcomes that can be expected from scorecards and from better corporate governance practices are described in Section 4.4.1, under the heading “Engage early adopters,” and in Section 5, “Measurable outcomes.” Table 2.1 (on page 5) provides a sample of actual outcomes taken from the case studies found in Section 5.

Who can use a scorecard?
Potential users of scorecards include companies, regulators, stock exchanges, institutes of directors, and development finance institutions (DFIs). Each is likely to have somewhat different goals. Companies tend to be more interested in addressing the concrete day-to-day issues they face in their governance. Regulators and stock exchanges tend to be more interested in measuring code compliance and drawing conclusions about the effectiveness of the regulatory framework. DFIs are usually interested in encouraging market-level change in corporate governance practices and transferring knowledge and skills to local counterparts.

Each user will likely play a different role in the development of a scorecard. It is useful to distinguish between the roles of different users to see how and what each contributes.

Below are three main user roles:

1. **Initiator**: The initiator is the institution that suggests undertaking the development of a scorecard. The initiator will typically seek to test the concept with a number of local stakeholders, establish whether a scorecard has utility, and encourage implementation. The initiator's role is to catalyze action. It may seek other institutions to lead and implement. IFC often finds itself in the role of initiator.

2. **Owner**: The owner of a scorecard project is the institution that takes a leadership role and primary responsibility for implementation. Ideally, the owner is a local institution. Ownership with a local institution promotes sustainability through a knowledge transfer to local partners.

3. **The beneficiary**: All the institutions involved in the development of a scorecard will derive some benefit. A regulator may extract information important for the development of sound policy, a stock exchange may enhance its image as a trading location, and a business association may provide a valuable service to its members. The ultimate beneficiaries are the companies whose governance practices are being assessed.

Though scorecards are often initiated by regulators, anybody can initiate or own a scorecard. In practice, institutions may play multiple roles.

**What can scorecards help different users achieve?**
Scorecards bring different benefits to different users. Table 2.2 (on page 6) shows a broad group of potential users and the benefits that can accrue to them.
Table 2.1: Sample of Measurable Outcomes

For a small listed company:
- Appointed personnel to improve and maintain good governance practices;
- Developed written policies and procedures;
- Enhanced transparency toward all shareholders and the markets;
- Created recognition of the company as a governance leader and a quality investment;
- Developed commitment to good governance at board and executive levels;
- Created better understanding of governance and how it affects company operations;
- Enhanced protection of minority shareholders;
- Provided a better understanding of governance strengths and weakness; and
- Led to a roadmap for future improvement.

For a chamber of commerce:
- Raised awareness of corporate governance issues;
- Generated real-time information that allowed comparison of any company to a peer group;
- Created a network of consultants to advise enterprises on their governance;
- Led to the development of numerous governance action plans developed at the company level;
- Plans led to actual changes in governance practices in numerous enterprises; and
- Allowed generation of aggregated data on governance practices—broken down by sector, size, region, and the quality of governance.

For an institute of directors:
- Raised awareness of corporate governance and maintained public attention over a number of years;
- Led to the development of governance action plans within listed companies;
- Led to measurable improvement in governance practices of companies over time;
- Created incentives for better governance through awards programs and disclosure;
- Led to the creation of institutions (clubs and discussion groups) to perpetuate good governance practices;
- Improved the reputation of the country for its corporate governance practices; and
- Generated information useful to policymakers on the governance practices of listed companies, state-owned enterprises, and banks.

For a stock exchange:
- Measured changes in governance practices among listed companies over time;
- Created collaborative relationships between the stock exchange and listed companies;
- Created incentives to improve governance through competition between companies;
- Improved public awareness of corporate governance;
- Generated useful information for the stock exchange, regulators, and policymakers; and
- Enhanced the reputation of the stock exchange and the country as an investment destination.

For a regulator:
- Permitted verification of levels of implementation of national code as well as legal compliance;
- Provided indications of the effectiveness of codes and the degree of implementation of company law;
- Permitted identification of governance practices where companies are relatively strong or weak;
- Generated data on governance practices over time, thus permitting the identification of trends; and
- Forced companies to conduct rigorous self-checking of their governance practices.
Scorecards benefit different users

“There has been strong interest in governance scorecards from many different users, including regulators, companies, investors, students, and researchers.”

- Nguyet Anh Nguyen, Operations Officer
Vietnam Corporate Governance Project, Vietnam

<table>
<thead>
<tr>
<th>Who can use a scorecard?</th>
<th>What can a scorecard help achieve?</th>
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<tbody>
<tr>
<td>Companies, company boards, individual board members, and executives</td>
<td>• Conduct self-assessments or facilitated self-assessments and receive support through consultants</td>
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<td>• Improve governance practices</td>
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<td></td>
<td>• Improve board function</td>
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<td>• Improve company reputation in the markets and among shareholders</td>
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<td></td>
<td>• Help report to regulators and stock exchanges</td>
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<td>Membership organizations such as institutes of directors, chambers of commerce, or business associations</td>
<td>• Encourage better governance practices among companies/members</td>
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<td></td>
<td>• Assess the status of governance practices within a country</td>
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<td></td>
<td>• Raise public awareness of governance issues</td>
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<td>• Educate companies and the public on the impact of governance practices</td>
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<tr>
<td>Self-regulatory organizations such as stock exchanges, as well as regulators and government institutions</td>
<td>• Assess and encourage compliance with codes and basic elements of company law</td>
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<td></td>
<td>• Create incentives for better governance</td>
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<td>• Improve the function of the capital markets</td>
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<td></td>
<td>• Gather information to guide the development of law and codes and improve the regulatory framework</td>
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<td>• Develop market indicators/investment indexes</td>
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<td></td>
<td>• Provide a basis for companies to report on their governance</td>
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<td></td>
<td>• Enhance the reputation of the country’s capital market</td>
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<tr>
<td>Development finance institutions, including IFC</td>
<td>• Encourage the development of sound capital markets</td>
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<td></td>
<td>• Provide knowledge transfer to local counterparts on how to conduct scorecard evaluations</td>
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<td></td>
<td>• Raise awareness of the importance of governance</td>
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<tr>
<td>Banks and other lenders</td>
<td>• Supplement bank credit-review and credit-approval processes with assessments of governance</td>
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<td></td>
<td>• Make better lending decisions through better risk assessment</td>
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<td>Academia</td>
<td>• Provide the basis for academic research</td>
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This introduction has defined some basic terms and concepts that are used throughout the supplement. One additional term that needs definition is scorecard project. A scorecard is not just a simple assessment of company practices or the filling in of a questionnaire. What is involved is a multifaceted, multiplayer project designed to create incentives, change practices, and develop new attitudes toward governance.