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Governance Indexing & Screening Tool (GIST)

2017

Governance Indexing & Screening Tool (GIST) is a diagnostic product of Deloitte. GIST is an in-depth, risk-based governance analysis methodology, aimed at assessing corporate governance at an individual company from the perspective of its potential role in long-term value creation.

Inspired by guidelines of the Organization for Economic Cooperation and Development (OECD) and the International Corporate Governance Network (ICGN), this tool measures the overall strength of governance practices along five main axes and identifies opportunities for improvement in each area. GIST is intended to ensure global applicability of its criteria and consistency in the resulting index values. GIST incorporates the extensive experience of Deloitte in emerging markets and accounts for the specific risks that these environments entail.

The GIST Index is measured from "1.0" through "10.0", with one-half point increments. Higher values of the GIST Index correspond to stronger governance standards. Each of the five constituent elements of the index is individually assessed and given an analytical commentary. In most circumstances each element carries an equal weight in the overall assessment. These elements are described in detail below.

1. Long-term corporate objectives

1.1 Strategy and risk management

1.2 Sustainable value creation and ethics

1.3 Compensation practices

This component of our analysis presents a judgment on the coherence of the company's objectives, policies and structures in creating value in a sustainable manner over the long term.

Most investors and other external constituencies expect companies to create value in a sustainable manner, and this focus has become notably pronounced in the wake of the Global Financial Crisis. We address the company's compliance with these expectations by analyzing its strategic planning practices, communication of corporate culture and values, risk management procedures, as well as the remuneration policies for directors and executives. In addition to the overall consistency of their design, these processes are analyzed from the perspective of their long-term orientation, focus on integrity and their ability to account for societal effects of the company's operations.

2. Board independence and minority influences

2.1 Voting-related rights

2.2 Minority activism and board independence

This component gauges the extent to which the governance architecture of the company can be described as a "shareholder democracy" – as opposed to a "blockholder's tyranny" or a "CEO's dictatorship". Independent directors and minority representatives on the board are key figures providing a counterweight to the generic power of executives and/or significant shareholders. Virtually all well-governed international companies have a significant presence of active independent directors on their boards ensuring that decision-making power is not usurped or abused by any particular interest group.

The scope of voting rights provided to equity holders and their combined voting power also contribute to the balance of influences in the governance system. Independent directors have a clearer vision of their role on the board, and greater autonomy, if their appointment reflects mandates of trust from a multitude of shareholders – as opposed to blockholder or management goodwill.

3. Alignment of controlling shareholders

This element of our analysis addresses the extent to which significant shareholders, where present, may be subject to conflicts of interest or whether their motives may otherwise differ from the interests of other equity holders.

Concentrated ownership is not uncommon even in North America and represents a dominant ownership pattern in most parts of the world. The influence of blockholders, such as founding families or governments, is often seen as a primary source of governance risks in many markets globally. Significant owners are inherently powerful actors in corporate governance, yet they differ considerably in terms of goals, resources and extent of involvement with their investee companies. Some blockholders are benevolent and remain at arm's length in their dealings with the company, if any. In this case, concentrated ownership may be a neutral or a mildly positive governance factor overall. Other blockholders are intrusive and may have difficulty distinguishing corporate from personal assets, with very different consequences for the governance framework. The extent to which blockholders are subject to conflicts of interest and able to manage them, as well as their track record in the treatment of minorities, provides an important indication of the scope of associated governance risks to all external constituencies and the company as a whole.

4. Board behavior and responsibilities

4.1 Skills and experiences of directors

4.2 Board structure and duties

4.3 Board meetings, development and evaluation

The fourth element of our analysis addresses the capabilities and effectiveness of a company's board by analyzing its composition, structure, authority, and procedures.

A board is the keystone of corporate governance architecture at any company, as it is entrusted with the unique role of providing guidance and oversight to management and looking after the interests of all shareholders in the company's business dealings. The effectiveness of the board in its mission is affected by many considerations beyond independence (addressed elsewhere in our analysis). Additional considerations that define the overall capability and effectiveness of the board include its size, industry expertise and the functional skill mix of its members, frequency and format of board meetings, as well as the composition and functioning of board-level committees. Furthermore, the scope and clarity of the board's authority, the culture of open debate and approach to self-assessment practices contribute to the board's overall effectiveness.

5. Shareholder protections and transparency

5.1 Ownership rights

5.2 Disclosure, transparency, and investor relations

5.3 Audit

This component of our analysis gauges the company's strength in supplying shareholders and other external parties with timely and detailed information on its operations and performance, and ensuring adequate protection of their ownership rights.

While in developed countries, investors may often take for granted such matters as ownership transparency, full and timely financial disclosure, rigorous audit process, registrar's independence, fair dividend procedures and preemption, it may be imprudent to count on the same protections in emerging economies. At the same time, these aspects are very important for the correct valuation of investments and performance of companies, analysis of risks, as well as fair and predictable distribution of cash flows.

Disclosure standards, audit requirements and ownership rights are significantly influenced by the country-level legal and regulatory environment, however, cross-border regulatory spill-overs are becoming increasingly important. Moreover, there are many other reasons why wide differences exist in levels of transparency and ownership rights across individual companies within the same jurisdiction, such as the influences of foreign ownership or the founders' philosophy. Owing to the discipline imposed by capital markets, more and more companies across the globe seek to provide high level of disclosure and investor protection, regardless of the regulatory requirements of their home markets.

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