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Monitoring Corporate Governance in U.S. and European Media Firms

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Large media companies today are billion euro firms that play significant roles in the public and economic lives of communities and facilitate the roles of citizenship. In addition to social and cultural criteria, those who monitor media performance need to consider whether media firms embrace accepted good business practices and if their overall business conduct meets the expectations of responsible corporations. In recent decades corporate governance analysis has become an important means for assessing the accountability of companies, and it has particular relevance to media companies.

This chapter lays out the rationale for corporate governance assessment, issues that are the focus of attention, and the means for monitoring media firms' performance.

Debates about company performance, managerial behavior, and corporate governance structures and mechanisms have existed since the development of the corporation (Chandler & Daems, 1980; Seavoy, 1982; Micklethwait & Wooldridge, 2003), the emergence of the theory of the firm (Coase, 1937; Cyert & March, 1963; Williamson, 1964), and the separation of ownership from control and management in firms (Berle Jr. & Means, 1932; Jenson & Meckling, 1976).

The progression of business ownership and management during the past three centuries from entrepreneurial capitalism to family capitalism to management capitalism has meant that owners have been progressively separated from business activities in many firms and today tend to rely upon hired agents (chief executive officers, chief operating officers, chief financial officers, and others) to provide management for the firms. This change has created distance between those who own firms, their values, and the effects of business behavior on their reputations and created different sets of incentives for those who manage rather than own the companies. Consequently, choices made in firms are often influenced by more than the profit and value maximization incentive of owners and related to incentives and interests of managers who do not own the firms (Cyert & March, 1963).

The reduction of market-based incentives that traditionally promoted responsibility and encouraged the preservation of company reputations created pressures for better corporate governance in recent decades. The corporate governance approach is based on the idea that owners are supposed to act and influence firms, to pressure and influence management, and to protect their interests as owner. In this conceptualization, shareholders should engage in active ownership, and large owners who are active over time are seen as preserving and adding value to the firm (Carlsson, 2001).

The goals of corporate governance are to provide more oversight and constraints on corporate managers, to ensure good management practices, to create financial transparency, to promote independence of boards of directors and auditors, to enforce adherence to fiduciary duties, and to balance power and flow of information between owners/investors, boards, and top managers. The ultimate objectives are to protect firms from damaging effects of poor or dishonest managerial choices and actions and to promote the social objectives of protecting investors and the capitalist system, creating clarity in decision making authority and processes, making more information about the operations of the firm available, and increasing the accuracy and veracity of information given public and owners. These business goals coincide with many social philosophies and goals, even those of persons who hold business in low regard.

Good governance practices are especially germane to media firms because many became publicly traded firms and grew in scale and scope during the past 50 years. Although relevant to all firms, the significance of the best practices for media firms is heightened because media simultaneously serve private and public goals. This is especially true because news, information, and public affairs activities incorporate public watchdog functions toward other social institutions and corporations, and this requires media companies to be credible, independent, and respected.

General and financial media report on the activities of other businesses and typically exhibit a populist distrust of large corporations, criticize authoritarian managers, condemn poor labor conditions and practices, denounce lack of transparency, and report on lack of compliance with good government principles. This oversight of media has been shown to pressure managers of businesses to behave in socially acceptable manners (Dyck & Zingales, 2002). If media are to be credible in their assessments of other firms, however, they must embrace and follow the best practices themselves.

Central elements of corporate governance

Corporate governance is concerned with owner and management relationships, distribution of power in firms, and accountability in corporations. Governance structures and processes are inextricably linked to the environments in which corporations are created and operate, of course, and corporations are legally created entities with specific rights and responsibilities that differ depending upon the nation in which they were established, their organizational forms, and whether shares are privately held or publicly traded. Publicly traded firms typically have more corporate governance responsibilities under law and in regulations established by the stock markets on which their shares are traded. Governance is thus a function directed by the integrated principles and requirements of corporate law, securities law, stock market rules, and accepted accounting standards.

The contexts in which governance takes place thus differ depending upon the location of the firm, and emphases may be placed on different factors by the regulatory environment. If one considers differences in North American and European contexts, for example, there is an Anglo-American tradition in which a stronger shareholder orientation influences governance structures and processes. On continental Europe, however, many nations have a stronger stakeholder orientation in which the interests of communities, labor, and social organizations in governance are also recognized.

In some countries and legal traditions, companies are governed by a single board of directors, whereas in others a dual board splits strategic and operational activities from supervisory functions such as financial monitoring and other fiduciary responsibilities. In some countries there are no requirements for board membership; in others there are specific educational and competence requirements. When one considers corporate governance issues, then, one must be cognizant of the specific environment in which firms operate because it influences the structures and strength of governance and the conditions under which ownership and management influences take place. This occurs because commercial law in the Anglo, Anglo-American, Latin, and Germanic traditions takes differing approaches relating to issues such as shareholder primacy, board structure, director duties, and takeover protections.

Agency theory explains tensions and conflicts that result from corporate ownership and management. It recognizes that agents (managers) and owners (principals) can have different and conflicting goals, risk preferences, information asymmetry, and needs to maximize factors at the expense of the other (Eisenhardt, 1989). In the traditional view of agency theory, diffusion of ownership is seen as leading to less control over management, which can result in inefficiency and declining performance (Berle & Means, 1932). Contemporary uses of the theory, however, recognize that there are times in which the diffusion of shares can be an advantage by reducing the cost of capital, increasing market value, or overcoming regulatory barriers (Demsetz & Lehn, 1985).

The range of interests represented by corporate stakeholders is thus critical to choices made within firms and to where the power to make those choices is located in the firms. Power and strategic control can be in the hands of the board of directors or the CEO depending upon their nature and personalities, upon power-sharing arrangements between them, and upon the activism of directors and major investors. Too much strength in either the directors or CEO can lead to strategic and operational difficulties and, sometimes, to practices that ignore interests of shareholders; too much activism and influence by major investors can lead to diminished attention to the interests of other investors, managers and the public.

Contemporary corporate governance discussions thus revolve around desires to achieve an appropriate balance of power and flow of information between owners, boards, and management. Concerns over corporate governance mechanisms and effectiveness have been heightened by corporate scandals, changes in governance at state-owned companies, internationalization of capital, the increased importance of institutional investors, and desires to promote economic growth in recent years (OECD, 2003).

Struggles over strategic decisions and corporate governance structures in major media firms—such as Bertelsmann, Disney and Time Warner—and claims of illicit and corrupt practices in firms such as Hollinger Inc., and Vivendi Universal have led to increased concerns over corporate governance and the balance of power within media firms in recent years.

Principles of Good Governance

During the past decades, a variety of campaigns, lobbying, and research promoted by desires to stabilize capital markets, protect investors, and promote higher financial, social, and ethical standards has emerged. Dozens of organizations representing institutional and individual investors, social advocacy groups, corporate officers and directors, and company auditors have become active. Their activities have spawned advocacy centers, research centers, consultants, and newsletters, magazines, and journals devoted to corporate governance. These groups, as well as stock exchanges, chambers of commerce, and regulatory organizations have issued guidelines and rules to promote practices of good corporate governance.

The Organization for Economic Co-Operation and Development—comprised of 30 member countries from developed market economies in Europe, North America and Asia—has identified 12 key standards as principles of corporate governance (OECD, 1999) and recently revised and clarified principles in response to contemporary events and comments by relevant parties (OECD, 2004). Large institutional investors have been particularly active in promoting good corporate governance practices. A leader in that regard for many years has been the California Public Employees Retirements System (CalPERS), which has been active in setting both U.S. and international corporate guidelines and other principles and practices for effective governance (CalPERS, 2004).

In the wake of accounting and corporate governance scandals at the millennium, the U.S. Congress enacted the Sarbanes-Oxley Act (2002) that required changes in public disclosure and independence of audit committees and auditors, and the European Commission has embraced rules promoting more transparency and disclosure.

If one considers that range of views represented by investors, managers, regulators, and advocacy groups, there is general consensus on some basic principles of good corporate governance. These include the desire that companies have clear corporate governance principles or guidelines of their own, that there be appropriate internal and external audit functions and that auditors be independent, that transparency about governance processes and decisions be evident, that conflicts of interests are controlled, that shareholders have equitable rights, that members of boards of directors should be independent from the management, and that compensation choices of managers be recommended by a committee with independence from the management.

Studies of corporate governance show that reputation of a firm and its executives affect sales and strategies, and three quarters of chief executive officers in the

U.S. believe corporate governance is an aspect of social responsibility that will grow in importance in the future (Pharoah, 2003). The persons who influence companies through membership on boards of directors have been widely studied to understand how their backgrounds and interests affect performance, and it has been discovered that members with financial, marketing, manufacturing, retailing and community service backgrounds tend to make different choices and produce different behaviors in companies (Zahra & Pearce, 1989; Dalton, Daily, Ellstrand & Johnson, 1998). Studies using the agency theory approach in recent years indicate that the presence of outside directors (those who are not managers or associated with the firm) results in higher profitability, but research based on stewardship theory shows that wealth generation and profits are higher if there are a greater number of inside directors, i.e., board members who are managers (Schellenger, Wood & Tashakori, 1989; Rosenstein & Wyatt, 1990; Pearce & Zahra, 1992). Other research has shown that links between the boards of companies in related or dependent businesses affect choices and performance (Pennings, 1980).

Governance issues in publicly owned media and communication Firms

Issues of corporate governance of media have become increasingly important because shares in nearly every major media company in the developed world are now traded on one or more stock markets. Few media firms have sufficient access to capital to keep them from becoming public if they are to become involved in large scale broadcasting, cable and satellite operations, or global markets. A wave of initial public offerings for media companies occurred in the 1960s and 1980s (Picard, 1994 and 2002), but the growth of the largest firms occurred in the 1990s, primarily as a result of mergers and acquisitions.

As with large firms in other industries, large globalized media firms are well known to investors. Firms such as News Corp., Time Warner, Walt Disney Co., and Viacom, are nearly household names. In Europe, many large commercial media firms—often family controlled—are also well known. Firms such as Bertelsmann (Germany), Bonnier (Sweden), Pearson (U.K.), Ringier (Switzerland), Schibsted (Norway) gain attention because they play significant roles not only domestically but internationally. Not all large firms are traded on stock markets, nevertheless how they are controlled and behave is significant to understanding the media environment and why we have the kinds of media and content offered.

Studies on media firms have shown that the companies pursue different managerial goals when they are publicly owned. Blankenburg & Ozanich (1993), for example, found that the degree of public ownership and outside control affects financial performance of companies, that they had more short-term financial aims and concentrated on higher return on equity and earning than privately-owned newspapers. These findings were later supported by Lacy, Shaver & St. Cyr (1996) and Chang & Zeldes (2002).

As public ownership increased, Compaine (1982) revealed the rising significance of institutional investors in media firm ownership and research related to concerns about their investment strategies and influence emerged (Meyer & Wearden, 1984; Blankenburg & Ozanich, 1992; Picard, 1994; Cranberg, Bezanson & Soloski, 2001).

Many observers have been concerned that public ownership of media has led to over-emphasis of the short-term interests of investors (Meyer & Wearden, 1992 (1984 in REFS); Blankenburg & Ozanich, 1992; Picard, 1994; Cranberg, Bezanson & Soloski, 2001) and can lead to practices that are damaging to media integrity and quality, but McGuire (2003) has shown that many institutional investors in newspaper companies take a long-term rather than short-term view. That can also be problematic, according to McGuire, because "some long-term investors may seek to impose their will in a way that can be viewed as detrimental to executives or employees of newspaper companies (p. 263)."

With the rise of publicly owned media firms and the appearance of governance concerns and conflicts within them—and because of importance to the social and political functions of media—issues of corporate coverage in media firms are growing in importance.

This is especially true because media and communication firms have not been immune to managerial scandals including criminality. The Mirror Group and Macmillan suffered from the theft of profits and pensions by Robert Maxwell (Greenslade, 1992). WorldCom approved unauthorized loans and payments to executives and experienced fraud by Bernie Ebbers and others (Jeter, 2004). Adelphia suffered similarly and the company and its executives were convicted for securities violations and fraud (Huffington, 2004). Lord Black was imprisoned for fraud and securities violations at Hollinger Inc. (McNish & Sinclar, 2004). Companies such as Vivendi Universal, Time Warner, Qwest, and Global Crossing have all faced governmental sanctions for corporate reporting violations and financial misrepresentation, and shareholders have filed suits against Walt Disney Co, CanWest, Bertelsmann, and Apple over governance issues.

Despite its significance only a limited number of scholars have attempted to assess governance in media firms. A 2004 exploratory study of 20 largest media companies worldwide found that their compliance with good governance principles was mixed and varied widely, that half had no corporate governance guidelines, and that compliance in companies such as Thomsen Reuters, VNU, EchoStar, Reed Elsevier, Lagardère compliance was significantly disappointing (Picard, 2004). It has been argued that deregulation initiatives led to diminished knowledge availability and board responsibility in AOL Time Warner and WorldCom (Gershon & Alhassan, 2003). The compositions of boards of directors and linkages between firms through interlocking directorships have been shown to affect media strategies, such as reinvestment) and company performance (Shaver, 2005; Shaver & Shaver, 2005; An & Jin, 2004 and 2005). An and Jin (2005) found differences in profitability and returns when outside directors came from financial institutions and leading advertisers. It has also been shown that media companies with high debt tend to have more directors from financial institutions (An & Jin, 2005).

McGuire (2005) found that the performance criteria used in awarding stock options to corporate executives of newspapers gave them incentives to focus on stock performance and margins, but not on improving products, customer satisfaction and sales. Nordberg (2007) argued that in cases of the sales of Dow Jones and Reuters, stewardship theory played a larger role in protecting the integrity of the news and influenced decision-making than shareholder value. Grubb and Law (2009) found that efforts to enforce transparency and accountability in government have had significant effects on behavior and processes throughout U.S. radio companies.

These studies of media show that significant issues within the realm of corporate governance have an influence on media company choices and behavior and that governance is relevant in monitoring the performance of media firms.

Monitoring governance in media firms

CG Monitoring should be part of a regular assessment of corporate media activities and how they carry out their responsibilities as companies.

Monitoring can focus on 8 criteria: 1) whether firms have publicly available corporate governance guidelines, principles, or statements; 2) whether there is equality of voting shares, 3) composition of boards of directors and the backgrounds of members; 4) the ratio of outside to company directors; 5) the ratio of independent to company members of the audit committee; 6) the ratio of independent to company members of the compensation committee; 7) Compensation criteria for bonuses and stock options, and 8) whether firms have interlocking directorates and with what types of companies.

These criteria are not media specific per se, but many of them are more important in media than in other firms because of the needs for media credibility, transparency, and trustworthiness.

The first criterion—the adoption and public availability of company corporate governance principles, guidelines, or statements—is evidence of discussion of governance issues and recognition of the importance of governance process to accountability and integrity within the firm. Leading companies in many fields have adopted such statements and provide access to them on the investor relations pages of their websites.

Governance guidelines are relevant to media, especially news media, because they promote business and corporate citizenship and should be business leaders in best practices, reliability and uprightness. The strongest statements for media companies, for example, might include statements about editorial independence from board or executive interference.

The second criterion—equality of voting rights—involves whether shareholders have equal voting rights and a balance of power exists among them. In companies with equality of rights, voting rights are proportionally split, the equity in the firm thus providing proportionally equal rights in voting for directors and officers, making changes in the company charter, and approving new stock issues. Some firms use classified stock that proportionally splits the equity in the firm but limits or removes voting rights in one or more categories of stock, which reduces the equality.

The equality provision is designed to ensure that persons owning shares are fairly treated in board and management decisions. A number of media firms have unequal share power to give members of the founding family more power; this is often justified as preserving editorial and content independence, but is also used to the advantage of family owners in some firms. In these unequal ownership structure relationships, monitoring should consider the extent to which the structure unfairly focuses on the economic interests of those with different rights.

The third criterion on composition of board of directors is designed to understand the persons who make the overall strategic choices for the firm and set the values of the firms and how their background and professional experience influence those decisions and cultural factors. Monitoring this factor can include where they received their educations, the organizational fields in which they have worked and gained business and social perspectives, and other personal factors that can be identified from publicly available information.

Just as individual owners—such as Silvio Berlusconi, Rupert Murdoch, and Arthur Ochs Sulzberger—can influence their firms in ways that help or harm public interests, other members of the boards excise some influence that affects the behavior of media companies. It is important to understand what colors their interests and to determine the extent to which boards include not only business perspectives but members with social and cultural perspectives as well.

The fourth criterion involving independence of directors is significant because where boards of directors are comprised solely of company officers, they are unable to offer perspectives and views not present in management meetings and do not necessarily reflect outside interests or owners' views. If boards are comprised of non-management directors they are able to provide more oversight than if they are officers. Though not related to specific media issues, they reveal the extent to which the board represents broader interests.

Board members who audit the company's financial activities are a fifth criterion for analysis. When the audit committees of boards of directors are comprised of company officers, they are interested parties, and the auditing lacks independence, thus creating the potential for manipulation of financial results. Having audit committees in which outside board members who are not officers are present is preferable, and this type of structure provides accountability that represents a best business practice.

Sixth, when the board members who set compensation for officers (usually called compensation, remuneration, personnel, or human relations committees) are company officers, they are interested parties and the determination of compensation lacks independence. News media often focus on abuses in compensation of business executives, so having independent compensation boards ensures that media themselves are following the best practices they avow.

The seventh criterion involves reviewing the factors that underlie non-salary compensation, such as bonuses and stock options that in many cases far exceed executive salaries. With knowledge of the measures used, an understanding of the incentives for executives to behave in different ways can be obtained and the influence of these on company decisions and behavior deduced. Best practices assess executive performance with a range of indicators of both the short and long-term health of the company and its public reputation, rather than only types of indicators that skew the definition of performance so executives have incentives to ignore important aspects of shareholder, public, and employee interests. This, of course, is especially relevant to the social and cultural roles of media firms.

Finally, the extent to which board members of media companies are also board members of other media companies and related firms—such as producers of necessary supplies, loans and other forms of capital, advertisers, or content distributors—helps one comprehend why certain decisions are made or the simultaneous behavior of both companies. Thus the number of interlocks and the firms involved in interlocks are relevant.

Issues of corporate governance and their effects have been outside the purview of media scholars for many years, but clearly how media enterprises handle such issues needs attention to understand how and why they behave as they do and to ensure they maintain the trust of investors, their audiences, and society as a whole.

Methods for monitoring media firms can range from simple measuring of the number of best practices they follow involving the 8 criteria discussed above to more focused and in-depth analysis of criteria in which lack of compliance is evident, why firms are less compliant, and the implications. The existing business and media literature on corporate government provides detailed methodology for measurement and extensive discussion of the rationales behind them.

Monitoring corporate governance provides another perspective on the economic and social effects of media and helps answer fundamental questions of why media companies behave as they do. This understanding is crucial for determining how to influence choices and behavior in media firms and how to fashion public policies toward media that incorporate effective mechanisms for achieving better performance.

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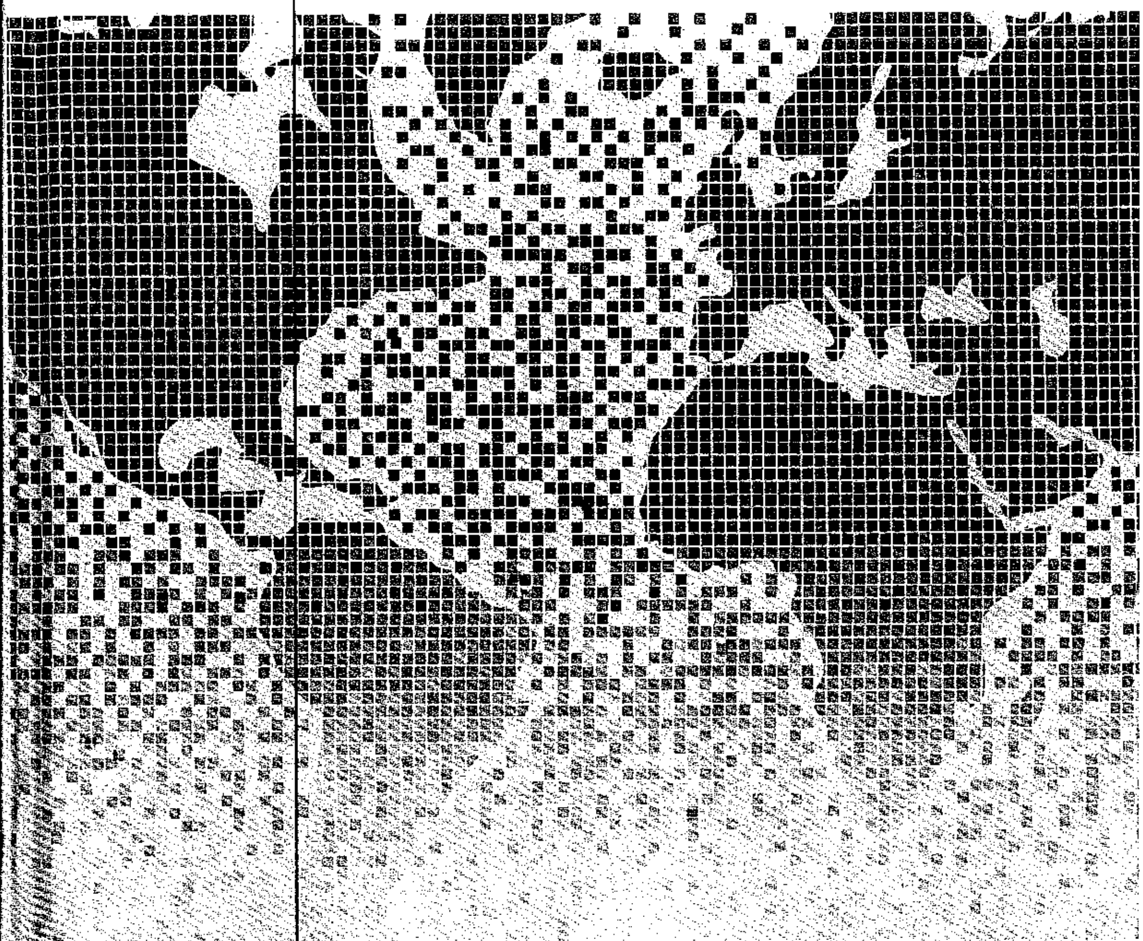
EDITED BY *Josef Trappel and Werner A. Meier*



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The Media and Their Contribution to Democracy

Library of Congress Cataloging-in-Publication Data

On media monitoring: the media and their contribution to democracy /
edited by Josef Trappel, Werner A. Meier.
p. cm. — (Mass communication and journalism; v. 2)
Includes bibliographical references and index.
1. Mass media—Political aspects. 2. Mass media—Political aspects—Europe—Case studies.
3. Mass media—Moral and ethical aspects. 4. Freedom of the press.
5. Journalism—Political aspects. 6. Journalism—Moral and ethical aspects.
I. Trappel, Josef. II. Meier, Werner A.
P95.8.O53 302.23—dc22 2010030329
ISBN 978-1-4331-1103-7
ISSN 2153-2761

Bibliographic information published by **Die Deutsche Nationalbibliothek**.
Die Deutsche Nationalbibliothek lists this publication in the "Deutsche Nationalbibliografie"; detailed bibliographic data is available on the Internet at http://dnb.d-nb.de/.

The paper in this book meets the guidelines for permanence and durability of the Committee on Production Guidelines for Book Longevity of the Council of Library Resources.

29 Broadway, 18th floor, New York, NY 10006
www.peterlang.com

Printed in Germany

Contents