The Mixed Results of Motivational Rankings

Rankings designed to shame companies into changing their behaviour often accomplish just the opposite.

As they push change programmes, one of the chief obstacles external stakeholders must confront is companies' preoccupation with profitability. In recent years, there has been a proliferation of rating and ranking systems designed to make firms pay more attention to issues such as corporate governance practices, environmental standards and fair employment contracts. External agencies apparently believe that creating a ranking around an issue helps raise the stakes, since no company wants to be seen coming up short against their peers.

However, we know that rankings can also prompt a backlash from the low-rated. For example, a 1996 study found that **business schools blamed *BusinessWeek*** rather than themselves for their disappointing performance in the magazine's annual rankings.

Our paper "**Board Reform vs. Profits: The Impact of Rating on the Adoption of Governance Practices**" (co-written by Timothy J. Rowley of Rotman School of Management), forthcoming in *Strategic Management Journal*, finds that rankings indeed may serve to alienate precisely those firms that external groups most want to influence. Low-ranked firms that are also low-profitability are apt to display more of the same behaviours that led to their low score. Therefore, rankings may be limited in their effectiveness with this group of firms.

Board reform

Out of all the relevant rankings we could have chosen to examine, we selected the Board Shareholder Confidence Index (BSCI), Canada's leading corporate governance ranking, which is a joint product of *The Globe and Mail* newspaper, Ontario Teachers' Pension Plan and the Canadian Coalition for Good Governance. The BSCI suited our purposes because it is transparent about its criteria, which include corporate governance practices broadly in line with board reform, e.g. board independence, independence of audit and compensation, and separation of the chair and CEO roles. Also, it should be noted that many corporate rankings (though not the BSCI) are administered by consulting firms that can and do enter into business relationships with the target firms, calling into question the objectivity of their results.

Comparing the rankings for 2001-2010 to the companies' annual proxy statements, we were able to determine whether low-ranking companies adopted board reforms, possibly in an effort to elevate their BSCI score. Further, factoring in ROA (return on assets) data from Compustat enabled us to analyse how the influence of the BSCI ranking varied according to the profitability level of the

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target firms.

Blaming the rankings

Our results showed that average-to-high performing firms as well as firms with slightly low performance both on the BSCI and profitability did take steps to improve their ranking next time around. However, as the performance on both counts declined, so did the likelihood that the firms acted on the BSCI's prescriptions. Our theory implies that, contrary to expectations, ratings can produce undesirable behaviours among poorly rated firms that also perform poorly financially.

The findings were supported by a series of interviews conducted with CEOs, board members, chairpersons and corporate secretaries at Canadian firms. One CEO of a low-ranking, low-profitability firm said, "Running a company means producing good returns for shareholders, not engaging in a check-the-box exercise. This system [BSCI] is out to get us." His aggrieved sentiment was echoed by many other interviewees in similar situations.

Profits vs. reforms

The above implies that rankings can be an effective tool for influencing the firms most likely to be amenable to external stakeholders' suggestions, i.e. those for whom profitability is a less pressing concern. But leaders of a company with serious financial woes may view a low score as adding insult to injury, and defensively downplay the ranking's relevance for their firm. Their resistance to ratings-consistent practices would be reinforced by pressure from shareholders and analysts to focus on the bottom line. When the chips are down, both human psychology and the business environment seem to prioritise profitability over reputation.

The influence of rankings upon corporate behaviour is therefore limited by the amount of attention leaders feel they can afford to expend on reputational improvements. While this may be an unwelcome finding for rankings administrators, it may not be a bad thing on balance. Rankings may be the best tool available for raising awareness and a sense of urgency around stakeholder concerns, but that doesn't necessarily equate to actual importance. Company leaders should certainly listen to important concerns, but without relinquishing their control of the organisational agenda.

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