THE EVOLUTION OF CORPORATE GOVERNANCE AND CONSEQUENT DOMESTICATION IN KENYA

EAMARC3 CONFERENCE PAPER
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BY
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| Graduate               | Doctor in Business Administration, Finance  
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| Thesis                 | Relationship between Corporate Governance and Financial Performance in the Financial Service Industry: Case of Companies Listed at Nairobi Securities Exchange in Kenya |

| Journal                | Relationship between Board Remuneration and Financial Performance in the Kenyan Financial Services Industry  
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<td>Published - International Journal of Financial Research - Vol 7, No. 2 (April 2016)</td>
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| Journal                | The Evolution of Corporate Governance and Consequent Domestication in Kenya  
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ABSTRACT

- **Governance** - determines the exercise of power in the management of economic and social resources for sustainable human development

- **Corporate Governance** - ‘the system’ by which companies are directed, organized and controlled’

- Influences growth in financial markets, plays central role in performance, capital formation, maximization of shareholder value and protection of investors’ rights

- The paper traces evolution of CG principles and practices, via the committees that produced Cadbury, Greenbury, Hampel, Higgs Reports, the Combined Code of CG, and the Organisation for Economic Co-operation and Development (OECD)

- These developments influenced the introduction and growth of CG principles and best practices in Sub-Saharan Africa and Kenya

- Led to the promulgation of the guidelines on principles of corporate governance for public listed companies in 2002 by the Kenyan Capital Market Authority
PURPOSE OF THE STUDY

- The purpose of the paper is to analyze historical development of CG, with specific reference to the sequential development of CG in the United Kingdom, OECD, Sub-Saharan Africa, and Kenya.
- The paper analyzes the nature of corporate governance guidelines and practices introduced in each epoch from pre-1900s to the 21st Century.
EVOLUTION OF CORPORATE GOVERNANCE

- Pioneering work of Berle and Means (1932) - [once modern corporations have grown to very large sizes - establish a separate system of control from that of direct ownership]

- CG is not a recent historical development, often presented as new with various mechanisms for controlling executive actions

- Created necessity for CG reform to minimize economic risks, foster public and investor confidence in the financial market, develop risk management structures to improve financial risk management and in turn financial performance

- One of the main drivers in the evolution of CG over the centuries remains corporate failures and systemic crises:
  - 1700s - South Sea Bubble - mismanagement of finance led to legalization of new business in England
  - 1929  - Stock market crash - USA
  - 1970s - Secondary Banking crisis - UK
  - 1980s - Savings & Loan crisis – USA
  - 1990s - East Asian Economic crisis
  - Company failures – BCCI, Enron, WorldCom, Parmalat, Lehman Brothers Holdings, Uchumi, CMC Motors
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<th>Year</th>
<th>Evolution of Corporate Governance</th>
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<td>Pre-1900</td>
<td>The origin of CG can be traced to the creation of the registered company under the Joint Stock Companies Act of 1844 (UK). This marked the beginning of the modern corporation that separates control from ownership (Berle &amp; Means, 1967). CG frameworks began developing to protect firms from the actions of professional managers with the passage of the Limited Liability Act of 1855 (UK) to protect shareholders from debt beyond their investment (Parker et al, 2002).</td>
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<td>1980s</td>
<td>CG gains prominence in the 1980s due to stock market crashes across the world and inability of corporate governance frameworks to prevent corporate failures (Francis, 2000).</td>
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| 1990s | Different CG structures are adopted across the world.  
- Countries that followed civil law (such as France, Germany, Italy, and Netherlands) developed frameworks that focused on stakeholders (Solomon & Solomon, 2004).  
- Countries that followed common law (such as USA, UK, Canada, Australia and New Zealand) developed frameworks that focused on shareholders returns/interests (Department of Treasury). |
| 1997 | Commonwealth Heads of Government develop the International CG Network to promote and coordinate research and development in corporate governance. |
| 1999 | Commonwealth Heads of Government establishes Commonwealth Association for CG (CACG), which developed CACG Guidelines - Principles for CG in the Commonwealth. |
| 1999 | Global CG Forum was developed by the World Bank Group and OECD. |
| 1998, 1999, 2000 | Regional conferences held in Kampala, Uganda in June 1998 and September 1999 to create awareness and promote regional co-operation in corporate governance.  
- June 1998 conference: there is a resolution that each member state should develop a CG framework and code of best practice, with particular emphasis on harmonizing frameworks under the East African region by establishing a regional body under East African Cooperation to promote corporate governance.  
- September 1999 conference: the June 1998 resolutions are re-affirmed and the need for good CG strengthened.  
- Uganda establishes the Institute of CG of Uganda to formulate a national code of best practice for corporate governance.  
- Tanzania organizes the East African Regional Workshop on corporate governance early in the year 2000.  
- In Kenya, the Private Sector Initiative for Corporate Governance continues to liaise with Uganda and Tanzania towards the establishment of a Regional Center of Excellence in CG. |
| Cadbury Report (1992) | - Outlined responsibilities of executive & independent directors, board audit committees, auditors responsibility to shareholders & board
- Listed Companies at LSE to adopt, comply with Code of Best Practice
- Increase number of independent non-executive directors
- Separation of CEO and Chair of the Board
- Set up sub-committees in the BOD - monitor & judge activities of mgt |
- Code of Best Practice framework for listed companies - decisions on remuneration
- Creation of Remuneration Committees consisting of independent directors
- Board to publish and disclose remuneration policies guiding & serving tenure |
- Separation of the CEO from the Board Chairman
- Process of nominating directors, remuneration, auditing by independent directors |
- Board effectiveness - independent directors & FP of listed firms
- Defined - 50% independent non-executive directors & their objectivity
- Recommended fair director’s remuneration to attract qualified individuals |
| Combined Code of Corporate Governance (2003) | - Included principles of CG; roles of board & chairperson; independent directors, formation, roles of audit & remuneration committees
- Recommended revised Code of Principles of Good Governance & Best Practice, guidelines on the recruitment, appointment, professional development of non-executive directors, board committees & performance evaluation checklist |
| Organisation for Economic Co-operation and Development OECD (1999) | o Provide a framework that governments adopt to improve the legal, institutional, and regulatory framework for CG. Also be adopted by stock exchanges, companies, and investors  
  o The OECD principles not legally binding, voluntary - act as a broad-based framework used by countries – develop own CG codes  
  o Principles revised in 2004 - emphasis on shareholder rights, value maximization strengthening shareholder rights, roles, ensuring disclosures are done in an accountable and transparent manner |
|---------------------------------------------------------------|
  o 1990s-multilateral bilateral donors factored governance agendas into their financial assistance to developing countries  
  o CG codes of SSA countries - Nigeria, Kenya, Ghana recommend non-executive directors, form audit committees with independent members, separate positions of chairperson & CEO as good practices of CG |
| Kenya (2002) | o Desire to institutionalize the principles of CG led to promulgation of the guidelines on principles of CG for public listed companies in 2002 by CMA  
  o Primary objective - to strengthen CG practices by public listed companies to promote the standards of self-regulation  
  o Both prescriptive and non-prescriptive guidelines to promote creativity and innovative dynamism to CG in listed companies  
  o CMA expects companies to adopt, nurture, encourage these CG best practices with minimum requirements |
PRINCIPLES OF GOOD CORPORATE GOVERNANCE PRACTICES

- Guidelines governing directors, chairman and CEO (separate), shareholders, audit, accountability & general practices

- Establishment of the board, its committees, director’s remuneration, supply, disclosure of information, board balance, appointments, re-election, resignation and multiple directorships

- Director remuneration - sufficient to attract and retain directors. Executive director’s compensation competitively structured and linked to performance, non-executive director’s in line with remuneration in competing sectors

- Directors of listed companies cannot hold more than five directorships in public listed companies. A chairperson position cannot be held in more than two listed companies at the same time

- Shareholders must participate in making major decisions in the company. Board to provide information on all relevant matters, operating position, prospects not limited to major disposal of the company’s assets, restructuring, takeovers, mergers, acquisitions

- There should be public disclosure in respect of any management or business agreements entered into by the Company
RECOMMENDED BEST PRACTICES IN CG BY PUBLIC LISTED COMPANIES

- Revolves - board of directors, chairman, chief executive, shareholders, general meetings, accountability and role of audit committees
- BOD responsible - fostering long-term business, maximize shareholder value, define mission, goals, risk policy
- Objectives - operations, mgt accounts, major capital expenditures, performance, identify opportunities, evaluate business risks, strategize; develop staffing, remuneration policy; review company’s internal control mechanisms and monitor governance practices
- Board balance independent, non-executive (1/3) & executive directors - of high calibre, expertise, credibility, gender representation
- Audit committees - 3 independent non-executive directors to oversee financial reporting process, ensure appropriate internal controls
- Equitable terms of shareholders, access to relevant information about corporate performance, security in transfer and registration of ownership, vote & seek clarifications on annual reports, distribute profits: dividend, bonus shares, script dividend or rights issue - in proportion of its shareholding
- All shareholders encouraged to participate in the annual general meetings and exercise their votes
CONCLUSION

- Corporate governance is concerned with the processes, systems, practices and procedures that govern institutions in via:
  - strong commitment from board and senior mgt
  - effective risk control
  - high level of transparency
  - well defined shareholders rights
  - disclosure of financial and non-financial information
  - effective monitoring of CG practices
  - long term commitment to good CG practices

- This generates positive returns for a company, boost investor confidence and maximize shareholder returns

- Understanding the evolution of corporate governance is therefore an important step in strengthening compliance with corporate governance principles and best practices
THANK YOU