Chapter 7 :

CORPORATE GOVERNANCE

There is a positive link between good corporate governance (CG) and good performance at the level of the firm. CG seeks to balance the interests of a company's shareholders with those of other stakeholders and stresses corporate social responsibility. For RMCs, good CG can be a source of competitive advantage while for the firm it facilitates access to external finance. African Heads of State have been promoting good CG and there has been good progress in most African countries. The main challenges include good economic governance, an enabling legal and regulatory environment, strong supervisory institutions with enforcement powers, a capacity for self-monitoring of compliance, a strong and well balanced Board of Directors, and timely and accurate disclosure of information. RMCs should ensure that appropriate regulatory bodies have been put in place to oversee CG standards consistent with the national company codes, and that they have sufficient enforcement powers, including the imposition of sanctions for noncompliance. Moreover, these national codes and standards need to be streamlined and simplified to take into account the limited capacity of small size firms.

Introduction

Corporate Governance (CG) is absolutely necessary for PSD in Africa. In launching the New Partnership for Africa's Development (NEPAD) in 1992, African Heads of States recognized that poor CG had resulted in missed opportunities for the continent's private sector to mobilize financial resources from both domestic and international capital markets and to operate in a transparent and socially responsible manner[132]. As such, they included CG as one of the four thematic areas that participating countries were obliged to integrate into national programs of action that would be reviewed periodically under the APRM. NEPAD subsequently requested that AfDB play a lead role in providing assistance to RMCs in implementing the APRM's recommendations and in identifying appropriate indicators and benchmarks to measure progress in CG. This, together with support from other development partners and a concerted effort aimed at addressing the other constraints to PSD identified in previous chapters, would allow the private sector in Africa to fully emerge as the engine of growth and development on the continent.

Definition and Objective of Corporate Governance

Although there is no single definition, CG can be defined as the institutional, legal, and regulatory framework that governs the relationship between the managers and investors in a firm, whether it be private, publicly traded, or state-owned[133]. It involves the pursuit of objectives by the board of directors and senior management that represent the interest of a company and its shareholders, including their effective monitoring of performance and the efficient use of corporate resources. Defined more broadly, CG implies that companies not only

132 Organization of African Unity 2001.
133 AfDB 2007.

maximize shareholder wealth, but balance these interests with those of other stakeholders, including the firm's employees, customers, suppliers, as well as the community within which they operate. The Bank adopts this broader "stakeholders" approach regarding its support to CG, stressing the importance of corporate social responsibility (i.e., social and environmental responsibility to a wider set of stakeholders)[134].

The need for CG arises because of the separation of management and ownership. This so called principal-agent problem occurs when the management of a company pursues activities or takes decisions which are not in line with the interests of the shareholders or investors in the firm and/or of the broader society. The absence of an overarching legal and regulatory framework with strong institutions involved in monitoring and enforcement as well as internal corporate procedures that ensure transparency, disclosure, and accountability could result in such outcomes. A system of good CG would therefore safeguard these interests and thereby mitigate the principal-agent problem.

The Importance of Corporate Governance for Private Sector Development

From the RMC's perspective, the objective of good CG should be to foster efficient, effective, and sustainable corporations that contribute to the welfare of society by creating wealth, generating employment, and providing solutions (or at least doing no harm) to the environment and other social challenges. The expectation is that these corporations would recognize and protect stakeholders' rights through an inclusive approach based on democratic ideals. From a company's perspective, the objective of CG is to facilitate access to external financing by ensuring that its board and management acts with integrity and probity, while being held accountable and responsive to the concerns and interests of its shareholders and employees.

There is a positive link between good governance and good performance at the level of the firm, as confirmed by a review of the literature carried out by the Global Forum on Corporate Governance[135]. The channels include increased access to external financing, lower cost of capital and associated higher firm valuation, better allocation of resources and management, reduced risk of financial crisis, and improved social and labor relationships. Moreover, the empirical evidence documents these relationships at the level of the country, the sector, the firm, and the investor[136].

For RMCs, good CG can be a source of competitive advantage. If the business environment is sound and predictable and there is a good CG regime in place, it increases the chances that companies will consider establishing themselves, relocating, and/or expanding their operations or activities in that country. In turn, this would improve economic performance at both the corporate and national level. Poor CG, on the other hand, could undermine a country's competitiveness and attractiveness to outside firms, which would in turn constrain the country's economic growth potential.

For firms, good CG attracts critically needed external finance by gaining the confidence of foreign and domestic investors and lenders. As discussed in Chapter 4, private equity capital (in ADF countries) and portfolio investment (in ADB countries) is potentially a key source of investment financing. In both cases, international investors are reluctant to hold shares in companies that do not meet minimum CG standards. Moreover, institutional investors have indicated a willingness to pay a premium for shares in a well governed company. With recent advances in communication technology, detailed information about individual corporations and their national CG framework is readily available and subject to public scrutiny. Good CG ensures these investors that their funds are being used in an efficient, transparent, and accountable manner.

CG is equally important for access to bank finance. As also noted in Chapter 4, African firms at present rely more on internal sources of funds and bank loans for financing their working capital and

134 Ibid.
135 Claessens 2003.
136 It is important to note that some of the studies suffer from endogeneity issues.

investment than on equity financing. One of the key constraints in banks extending credit to firms is the lack of credible, externally audited financial statements. Good CG, including the preparation of externally audited returns, should go a long way in facilitating bank credit to these firms.

Progress in Corporate Governance

As mentioned at the beginning of this chapter, CG has been mainstreamed by African Heads of States in NEPAD, through the APRM. This has provided participating African Union members with the opportunity to have other African countries review and assess their policies in the area of democracy and good political governance, economic governance and management, socio-economic development, and corporate governance (Box 7.1). As of January 2011, there were 30 member states participating in the APRM[137]. Between January 2006 and January 2011, 14 member countries have been reviewed[138].

Box 7.1: The African Peer Review Mechanism

NEPAD is an integrated strategic framework for Africa's socio-economic development that was adopted by the Organization of African Unity in 2001. It focuses on the linkages among economic growth, socio-economic development and political rule, and emphasizes the importance of good governance in all of these aspects. African leaders proclaimed the Declaration in Democracy, Political, Economic, and Corporate Governance at the inaugural AU meeting in 2002.

The NEPAD declaration was of particular importance because it acknowledged the many similar but un-integrated declarations and frameworks for Africa's way forward that had been made for two decades. The NEPAD declaration integrated them and made good governance its central plank. It placed new emphasis on certain preconditions for Africa's progress including the rule of law; human rights; regular elections; fighting corruption; ensuring transparency in monetary, financial and budgetary matters; providing an independent and effective accounting, auditing and banking system; making corporations responsible and accountable; providing peace and security; ensuring human and physical development; and promoting gender equality.

To enforce NEPAD commitments, the African Peer Review (AFRM) was formally launched by the Heads of State and Government in 2003. The peer review is a mechanism voluntarily agreed upon by African states themselves to monitor progress in governance and good practices in four thematic areas, namely democracy and political governance, economic governance and management, corporate governance and socio-economic governance. These thematic areas incorporate the critical preconditions for progress highlighted by the NEPAD declaration, but include many other aspects of governance that are to be evaluated. The objective of the evaluation is to make policies and practices of member states of the APRM, and eventually all African states, conform to commonly accepted African and Global governance standards. Following evaluation, experiences of the participating African countries will be shared; deficiencies pointed out, best practices encouraged, and needs addressed.

Source: NEPAD 2007.

137 These are: Algeria, Angola, Benin, Burkina Faso, Cameroon, Republic of Congo, Djibouti, Egypt, Ethiopia, Gabon, Ghana, Kenya, Lesotho, Liberia, Malawi, Mali, Mauritania, Mauritius, Mozambique, Nigeria, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, South Africa, Sudan, Tanzania, Togo, Uganda, and Zambia.

138 These are: Algeria, Benin, Burkina Faso, Ethiopia, Ghana, Kenya, Lesotho, Mali, Mauritius, Mozambique, Nigeria, Rwanda, South Africa, and Uganda.

The focus with CG has been on the promotion of ethical principles, values, and practices that are in line with the country's broader social and economic goals to benefit all citizens. In particular, the APRM focuses on:

- Rules providing the framework for the regulation of and support to economic activities;
- Rules and actions to ensure that business entities act responsibly with regard to human rights, social goals, and environmental sustainability;
- Fair and just treatment of all stakeholders (i.e., shareholders, employees, communities, suppliers, and customers);
- Reporting, disclosure, and accountability of directors; and
- Effective accounting and auditing of corporations.

There has been mixed progress on implementing good CG practices in African countries (Table 7.1, Box 7.2, and Annex 7.1)[139]. First and foremost, CG in Africa is undermined by the lack of progress in economic and political governance. RMCs are still plagued by deficiencies in their court systems whereby property and contractual rights are not protected and the resolution of commercial and employee disputes are slow and costly. Second, despite the good progress to date in developing a regulatory framework for CG, the implementation of these rules and regulations is deficient due to the lack of enforcement. Third, SMEs continue to face difficulties in accessing capital due to their underdeveloped and non-transparent accounting practices. This is also complicated by poorly defined property rights which impede their ability to meet collateral requirements. Finally, the existence of large informal sectors impedes fair competition with formal firms. This, in turn, often discourages firms in the formal sector from engaging in business practices that are compatible with good CG.

Table 7.1: Status of Corporate Governance Reforms in Selected African Countries

	CG Code in line with International Standards	Implementation of CG Codes	Compliance by SMEs	Financial Disclosure	Enforcement & Compliance Oversight	Accpountability of Management and Directors	Corporate Social Responsibility	Private Assoc. and Institutions	Minority Shareholder Protection	Weak Judiciary
Algeria	+	+	+/-	+	+	+	+	+		
Benin	+	-	-	-	-	-	-	-		
Burkina Faso	+	-	-	-	-	-	-	-		
Ghana	+	-	-	-	-	-	-	-		
Kenya	+	-	-	-	-	-	-	-		
Lesotho	+	-	-	-	-	-	+	+		
Mali	-	-	-	-	-	-	-	-		
Mozambique	+	-	-	-	-	-	-	-		
Niger	+	-	-	-	-	-	-	-		
Rwanda	+	-	-	-	-	-	-	-		
South Africa	-	-	-	-	-	-	-	+		
Uganda	+	-	-	-	-	-	-	-		

Source: NEPAD Africa Peer Review Mechanism (APRM) Country Reports.

139 APRM reviews have been conducted for 12 African countries, including Algeria, Benin, Burkina Faso, Ghana, Kenya, Lesotho, Mali, Mozambique, Nigeria, Rwanda, South Africa, and Uganda. APRM reviews have also been conducted for Ethiopia and Mauritius, but were not publicly available at the time of this report.

Box 7.2: Corporate Governance in Selected African Countrie

South Africa is amongst the best performers in corporate governance in Africa. Tremendous progress has taken place in implementing CG rules and standards, a process which culminated with the promulgation of the King I, II, and III reports. However, most stakeholders believe that more can be done, particularly in terms of updating the regulatory framework governed by key legislation, such as the 1973 Companies Act. Similarly labor laws are perceive by many to be too restrictive and constraint job creation. There are also shortcoming with regard to the plethora of oversight institutions, particularly in financial services supervision, which creates problems in terms of compliance and enforcement due to the multiple reporting obligations.

Mozambique is at the other extreme and is still in its embryonic stage. Public awareness of CG is still low and best practice is a new concept in most businesses except for foreign-based organization. However, following recent reforms in the financial sector, the concept is catching on rapidly and steps are being taken to prepare a National Code on Corporate Governance. Financial accountability is generally low, the implementation of the 2005 commercial code and the requirement to adopt International Financial Reporting Standards on publication of financial records of financial institutions and listed companies should greatly improve the situation over the medium to long term. Small and medium size businesses have low levels of transparency, complicated by lack of acceptable records.

Kenya's performance in CG is somewhere between that in South Africa and Mozambique. It has ratified and adopted the most significant international standards and codes for CG, but needs to extend them to the SME sector as well. Enforcement has been patchy, as the institutional capacity of regulators and supervisors has been limited. The legal framework governing accounting and financial reporting, professional education and training, professional associations, and enforcement mechanisms also need to be improved. Kenya's CG framework does not provide for the pooling of voting rights of minority shareholders. It has, however, effectively pursued a public awareness campaign on business policies and is collaborating with local business associations and non-government organizations to develop codes of ethics for businesses.

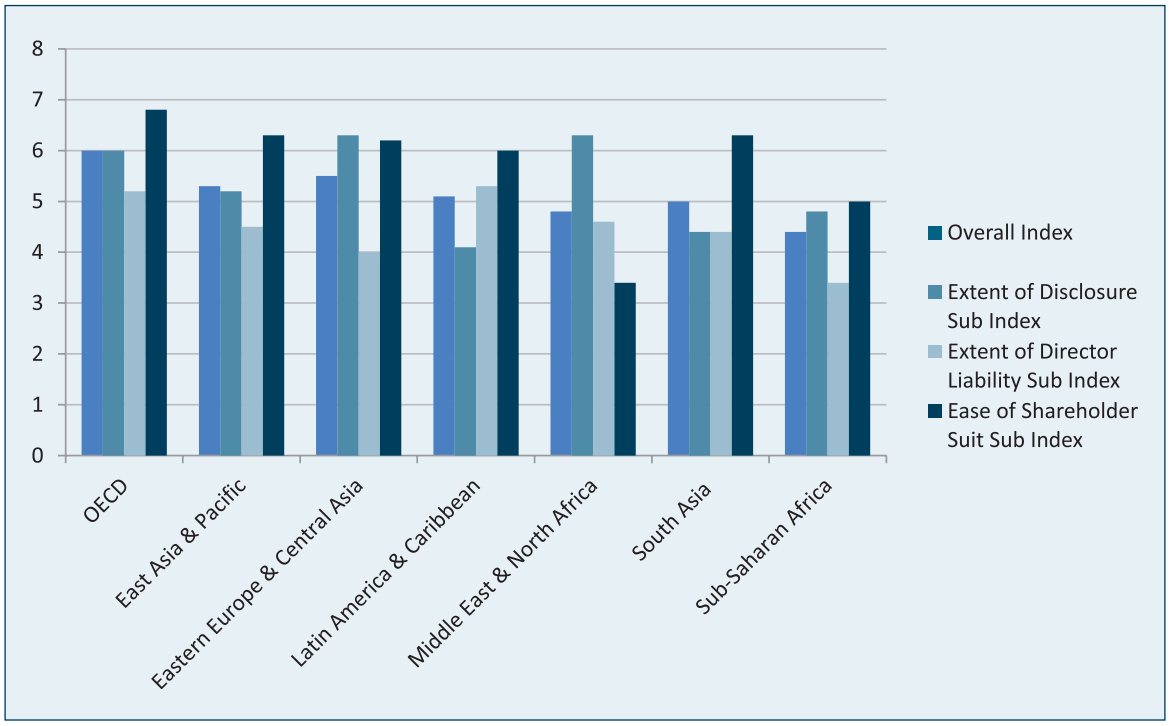
Source: NEPAD APRM Country Reports.

Measuring CG. It is difficult to measure and quantify CG because there are few objective indicators that are systematically collected across firms within a country, let alone across countries. The World Bank began to publish an "Investor Protection Index" as part of its *Doing Business Report*[140]. The index measures the strength of minority shareholder protection against misuse of corporate assets by Directors for their personal gain. It is an average of three sub-indices which are measures of the transparency of transactions, the liability for self-dealing by Directors, and shareholder's ability to sue officers and directors for misconduct. Although it is limited in scope and does not capture the full breadth of CG issues, it nonetheless provides a useful snapshot of a core aspect of CG that is comparable across countries.

Relative to other developing regions of the world, sub-Saharan African countries have the lowest overall level of investor protection next to the Middle Eastern and North African countries as measured by this index (Figure 7.1). It ranks lowest for the sub-index on the extent of director liability and second and third from the bottom for the ease of shareholder's suit and extent of disclosure sub-indices, respectively.

140 The Index measures and compares regulations relevant to the life cycle of small to medium-sized domestic businesses in 183 countries, with the most recent round completed in June 2011.

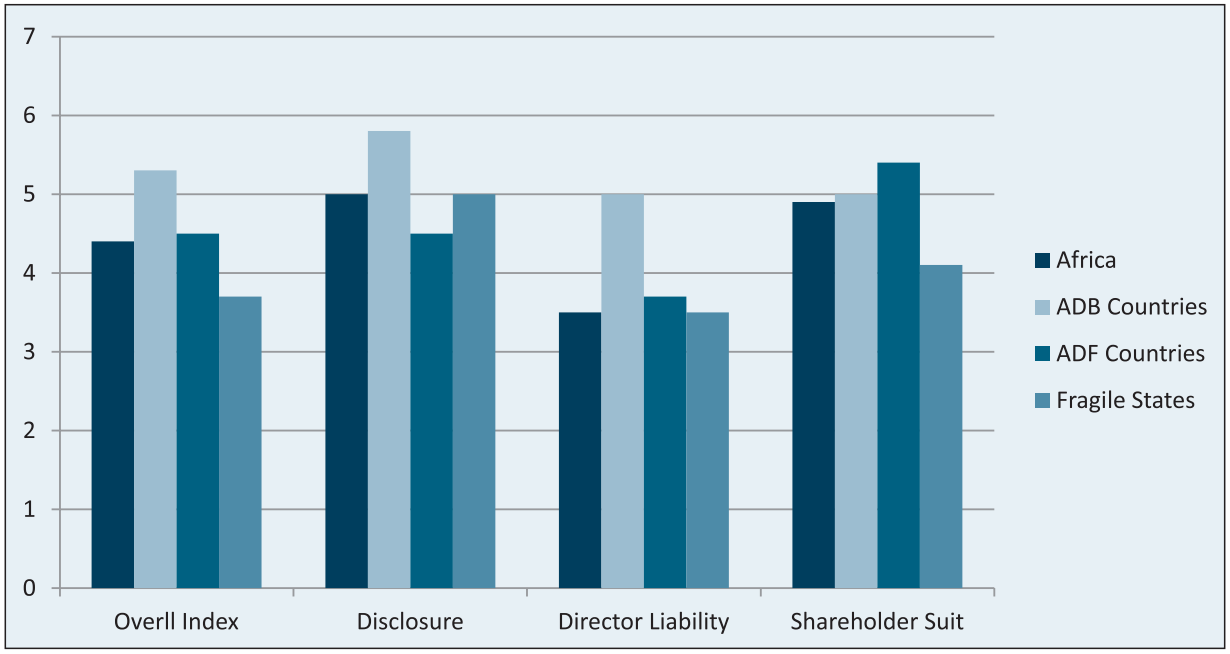
Figure 7.1: Strength of Investor Protection Index and Sub-Indices



Source: World Bank Doing Business database 2011.

Investor protection varies widely across African countries. ADB countries have the highest ratings across all indices with the exception of that for ease of shareholder suits (Figure 7.2). In the case of the latter, the strong performance of countries like Mauritius, South Africa, Swaziland, and Tunisia are offset by the relatively lower performances of countries such as Morocco, Botswana, and Gabon.

Figure 7.2: Strength of Investor Protection by African Country Groupings



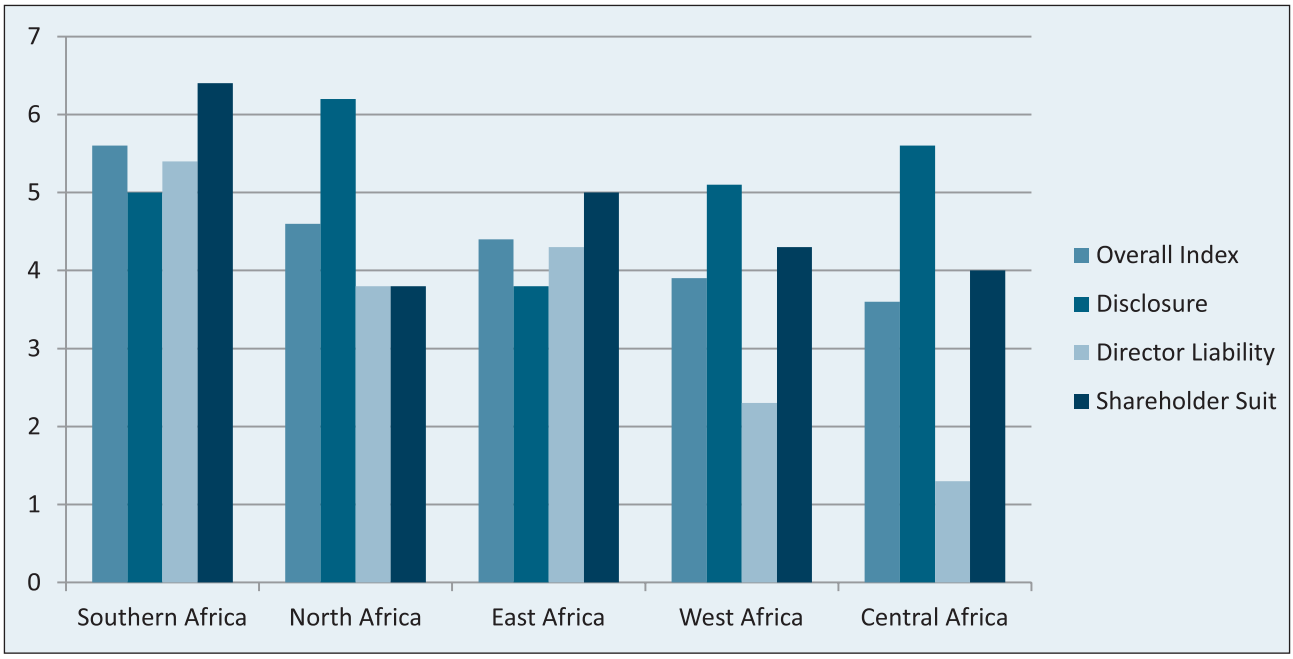
Source: World Bank Doing Business database 2011.

ADF country performance is mixed. Its overall investor protection rating is below that of ADB countries and higher than that of the Fragile States. This is also the case regarding the extent of director liability sub-index. However, it outperforms ADB countries with regard to the ease of shareholders suits sub-index and lags behind the performance of Fragile States on the extent of disclosure sub-index. Its relatively high rating with regard to ease of shareholders suits is due to the particularly strong performance by countries such as Kenya, Mozambique, Lesotho, Tanzania, and Zambia. In contrast, its relatively lower performance with regard to extent of disclosure is on account of the poor performance of countries such as Cote d'Ivoire, Gambia, Kenya, Lesotho, Tanzania, Uganda and Zambia which offset the strong performances by countries like Rwanda, Benin, Burkina-Faso, Cameroon, Mali, Niger, and Senegal.

In Fragile States, the high rating on the extent of disclosure sub-index relative to that for ADF countries is due to consistently strong performance by numerous countries, including the Central African Republic, Chad, Comoros, the Republic of Congo, Cote d'Ivoire, Guinea, Guinea-Bissau, Sierra Leone, Togo, and Zimbabwe. However, Fragile States consistently lagged behind both ADB and ADF countries with regard to the other sub-indices, particularly in the extent of director liability, in which two-thirds of the Fragile States were rated the lowest score.

Investor protection varies widely across the sub-regions (Figure 7.3). Southern African countries performed substantially better across most of the indices on account of the particularly strong showings by South Africa, Mauritius, Botswana, and Mozambique. Only in the case of extent of disclosure do southern African countries as a group fall below that of North African countries, although there are a greater number of individual strong performance in the South (South Africa, Botswana, Mauritius, and Zimbabwe) than in the North (Egypt, Morocco, and Algeria).

Figure 7.3: Strength of Investor Protection by African Sub-Regions



Source: World Bank Doing Business database 2011.

Performance in North Africa was comparable to that in East Africa regarding the overall investor protection index, with North Africa's particularly strong rating on the extent of disclosure sub-index offsetting its relatively poorer performance on both the extent of director liability and extent of shareholders suit sub-indices vis-à-vis East African countries. Notably, North African countries ranked the lowest of all the sub regions on the latter indicator, with the poor performance by Morocco, Mauritania, and Algeria offsetting the very strong performance by Tunisia in this area. In contrast, East

Africa countries ranked highest on this sub-index as well as for the extent of director liability sub-index. However, this was offset by being the poorest performer in all the sub regions for the extent of disclosure sub-index on account of very low ratings by Sudan, Uganda, Kenya, and Tanzania.

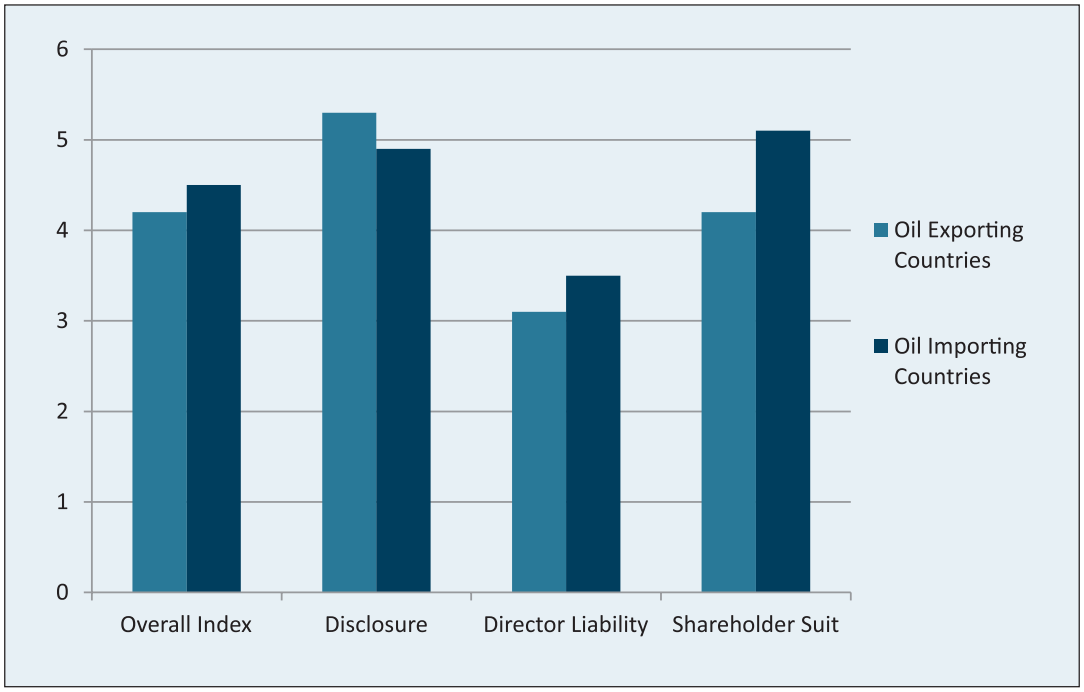
The West and Central African sub regions recorded the lowest ratings regarding investor protection. Both scored particularly low on the extent of director liability sub-index, with all countries with the exception of Nigeria, Sierra Leone, Ghana, and Cote-d'Ivoire (in West Africa) and the Democratic Republic of the Congo (in Central Africa) having rock-bottom ratings. However, the performance of these two sub regions exceeded that for North Africa regarding the shareholders suits sub-index and that for both East and Southern African countries regarding extent of disclosure sub-index. With regard to the latter, all Western African countries (with the exception of Cote d'Ivoire, Gambia, Liberia and Sao Tome and Principe) and Central African countries (with the exception of the Democratic Republic of the Congo) scored exceptionally high ratings.

Investor protection between oil exporting and oil importing countries was broadly the same, although the level and relative performance varied across the sub-indices (Figure 7.4). Oil exporters scored the highest-both in absolute and relative terms-on extent of disclosure sub-index. In contrast, oil importers scored higher on both the extent of director liability and the shareholders suit sub-index. For costal versus landlocked countries, there was no relative difference across each of the indices.

Main Challenges

The main challenges facing CG in Africa include: good economic governance, a legal and regulatory framework for CG, strong supervisory institutions with enforcement powers, a capacity for self-monitoring of compliance, a strong and a well-balanced Board of Directors, timely and accurate disclosure of information, and corporate social responsibility.

Figure 7.4: Strength of Investor Protection across Oil Exporting and Oil Importing Countries



Source: World Bank Doing Business database 2011.

Wider economic governance problems facing a country at the macro level will inevitably have direct implications for CG at the micro level. For example, many successful business persons in Africa become involved in politics. In such cases, there is a risk that the company's Board of Directors

and senior management become more concerned about advancing the business person's political ambitions than in maximizing shareholders' value. This is particularly true in family-owned or majority family-owned companies. In other cases, business persons may see politics as a means for expanding their personal interests through business related to government contracts. This could result in decisions being taken by government to award contracts to these individuals' businesses and/or the appointment of Directors and senior management that advance the business interests of the politician rather than of the electorate and thereby promote general corruption[10].

The legal and regulatory framework of CG at the country level is set through the national company codes. In principle, these codes specify the rights and obligations of a company, its directors, its shareholders, and other stakeholders. They also specify the disclosure requirements for companies and identify the division of responsibilities among the different supervisory, regulatory, and enforcement bodies in the country. Many RMCs still have antiquated codes inherited from colonial times or developed soon after Independence, while others have updated their codes. There are numerous guidelines for CG and examples of best practices regarding company codes, with the OECD Guidelines considered to be the standard bearer (Box 7.3)[11]. RMCs should begin from where they are and build on their existing structure and systems rather than applying codes and practices imported from abroad in a rote manner. To be effective, these codes need to be seen as African codes-developed, formulated, and ratified by Africans for the benefit of Africa. While they should clearly be brought into line with international standards, they should be customized to the country's context.

Box 7.3: OECD Principles of Good Governance

The OECD principles of good corporate governance framework are sub-dived into the following categories:

- Promote transparent and efficient markets, be consistent with the rule of law, and clearly articulate the division of responsibilities among different supervisory, regulatory, and enforcement authorities.
- Protect and facilitate the exercise of shareholders' rights.
- Ensure equitable treatment of all shareholders, including minority and foreign shareholders who should have the opportunity to obtain effective redress for violation of their rights.
- Recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- Ensure timely and accurate disclosure is made of all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
- Encourage the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders

Source: OECD 2002.

141 UNECA 2006, pg. 489.

142 These include the OECD Principles of Corporate Governance, the Guidelines and Principles for Corporate Governance in the Commonwealth, the Combined Code prepared by the Institute of Chartered Accountants in England and Wales, the Code of Corporate Practices and Conduct prepared by the King Commission in South Africa, and the ECA Guidelines for Enhancing Good Economic and Corporate Governance in Africa.

Strong supervisory institutions with effective monitoring and evaluation systems and enforcement capability are critical for good CG. The best Company Codes on paper will have minimal or no effect unless they are backed by an effective compliance system. There is an important role to be played, therefore, by supervisory institutions such as stock exchanges, security and exchange commissions, public enterprise commissions and, in the case of financial institutions, central banks and banking supervision commissions. However, at present there is a general lack of strong supervisory institutions in most African countries. Even in cases where such institutions exist, enforcement is rare and sanctions for violations even rarer.

Self enforcement of CG rules and procedures is generally preferable to government enforcement, if done properly. Compliance with these principles and practices should preferably take place voluntarily with the support of the relevant business association, and, ideally, by companies' Boards of Directors. There are numerous examples of professional and business associations taking on a lead role in defining and developing CG principles and best practices at the national level vis-à-vis its membership (Box 7.4– 7.6). In such cases, specialized institutions are often created to assist in the development, training, and dissemination of these principles and practices to member businesses, their boards, their senior management, and to wider parts of the business community.

Box 7.4: The Centre for Corporate Governance in Kenya

The Centre for Corporate Governance in Kenya has been instrumental through participatory processes in developing generic and sector specific corporate governance codes of best practices, covering all companies generally, state-owned enterprises, cooperatives, banks, reporting and disclosure and on the role, duties and obligations of shareholders and members. The Centre has also championed the creation of the Shareholders' Association and the Institute of Directors. It also offers training programs, including Commonwealth Certification, for Directors drawn from the public, private, and cooperative sectors. These and other activities are improving the standards of good corporate governance in the country.

The Institute of Directors (IOD) was established in 2003 and is based on the South African and British models. Its mission is to promote professionalism and enhance the standards and effectiveness of directorship. The immediate organization objective is to ensure that all directors are members. The IOD has members from all size organizations in Kenya, including SMEs.

The Kenya Shareholders' Association was formed in 2002 and is registered under the Societies Act. The goal of the organization is to create empowered shareholders that are able to play an effective role in the proper governance of the organizations whose shares they own. It has helps raise awareness of minority shareholders' rights and the need to form minority shareholder coalitions. It offers CG education, information, research and documentation services and advocacy to shareholders in Kenyan organizations and has designed training programs for managers on reviewing annual reports and other ownership tools.

Source: NEPAD APRM 2006, pg. 197.

Box 7.5: Institute of Directors and Institute of Management in Malawi

The Institute of Directors of Malawi was set up in 2001. It has benefited in recent years from an IFC Global Corporate Governance Forum project funded by the Flemish Government which provided seed funding and technical support. The IOD has produced a corporate governance curriculum for training members of boards in Malawi and trained trainers to deliver the curriculum.

The curriculum is comprehensive, consisting of 23 half-day working shops which cover all aspects of CG, from the role of the board, financial oversight and reporting, corporate social responsibility, and ethics. Members of the Boards of financial institutions and listed companies have been attending these workshops. The Malawi Institute of Management was commissioned by the Government of Malawi to deliver CG training for Boards of State Owned Enterprises. It partnered with Kenya's Institute of Directors (IOD) to deliver these training sessions.

Source: AfDB 2010 (a).

Box 7.6: The South African King Commission

In 1994, the South African King Committee on CG, headed by former High Court judge Mervyn King, published its seminal report (King I). The report advocated an integrated approach to good CG in the interests of a wide range of stakeholders. Although groundbreaking at the time, the evolving global economic environment, together with recent legislative developments necessitated the updating of King I.

In 2002, the King II report was issued. It applied to all companies with securities listed on the Johannesburg Stock Exchange; all banks, financial, and insurance entities; and certain public sector enterprises and agencies. It required companies to implement "sustainability reporting" as a core aspect of CG, which became the widely accepted practice in South Africa. It called for a move away from the single bottom line (i.e., profit for shareholders) to a triple bottom line, which embraced the economic, environmental, and social aspects of a company's activities. However, King II also needed to be updated in order to respond to the lingering trust deficit among civil society of the intentions and practices of big business, as well as concerns among business decision makers that sustainability reporting was not fulfilling their expectation in a cost-effective manner.

In response, the King III report was created in September 2009. It broadened the scope of CG by maintaining that: good governance was essentially about effective leadership; sustainability was not the primary moral and economic imperative; innovation, fairness, and collaboration were key aspects of the transition to sustainability; and social transformation and redress are important and need to be integrated with the broader transition to sustainability.

In contrast to the two previous King reports, King III applies to all entities regardless of their form of incorporation. It is at the forefront of CG internationally by focusing on the importance of annual reporting on how a company has both positively and negatively affected the economic life of the community in which it operates. Companies are required to report on how the company intends to enhance those positive aspects and eradicate or ameliorate any possible negative aspects. Its framework is "principles based" and there is no "one size fits all" solution. Firms are encouraged to tailor the principles of the Code as appropriate to the size, nature, and complexity of their organization. King III

recommended that all entities disclose which principles and/or practices they have decided not to apply and explain why. This level of disclosure is intended to allow stakeholders to comment on and challenge the Boards involved to improve the level of governance within an organization.

Source: Institute of Directors Southern Africa and King Committee on Corporate Governance 2009.

Role of Board of Directors. A strong and well balanced Board of Directors is important for good CG. As noted, many companies in Africa are family-owned. In most cases, the Chief Executive Officer (CEO) is the head of the family and other family members or persons close to the CEO dominate the Board. In other cases, there is a lack of separation and independence of the company's Board of Directors from the senior management of the company. Shareholders' interests – particularly minority shareholders – likely receive limited attention.

MNCs CG frameworks should therefore seek to ensure that companies' Boards are empowered to provide strategic guidance to the company, effectively monitor the companies' senior management, and ensure that the company is held accountable to its shareholders. Boards need to be well balanced-not only with both executive and non-executive directors, but more importantly, with outside or independent directors who are not tied to senior management and do not represent any shareholders of the company. These Directors also need to have the skills or be well trained in asking the right questions, having the capacity to remove CEOs who are not performing, and ensuring the separation of the CEO's position from the chairman's. The building of such knowledge and capacity through well designed training and education programs is essential at all levels including for directors, senior management, and regulators if shareholder's interests regarding the performance and management of these firms are to be safeguarded.

Information Disclosure. Another key aspect of CG is the timely and accurate disclosure of information regarding a company's operations, including its financial situation, performance, ownership, and governance. Shareholders have a right to full and equitable access to such information and the governance procedures should seek to safeguard these rights. Companies need to provide accurate and timely financial statements that have been reviewed by the company's internal audit unit and, ideally, audited by an independent external accounting firm. Even in cases where there is an external audit, Boards need to ensure the independence of the external auditors from the senior management and directors of the company, as all too often these relationships compromise the objectiveness of the reporting.

Corporate social responsibility and the role of the company vis-à-vis other stakeholders are also important components of CG. Companies have broader responsibilities to the community at large in terms of doing no harm and, ideally, contributing to the creation of wealth, employment, and growth. This includes, but is not limited to, environmental protection, human rights, health and safety standards, and labor rights. The CG framework should therefore recognize the rights of stakeholders that have been established through law or mutual agreements as well as encourage the active cooperation of corporations and their stakeholders.

Addressing the Challenges in Corporate Governance

Africa has by a vast array of companies by size and classification. Foreign-owned companies and MNCs are generally governed by CG practices in their home country. In most cases, these standards are quite high and should not be the focus of RMC's time and effort. For firms listed on national stock exchanges, CG standards are usually set by the exchange itself and/or the national securities and exchange commissions. Similarly, financial institutions are supervised by the central bank or the national banking supervision commission, who also set CG standards and norms for these institutions. State owned enterprises are supervised by the relevant public enterprise commissions, which oversee and enforce the rules and procedures set

forth by the national laws on public corporations. In each of the above cases, the focus of RMC's efforts should be on ensuring that these bodies not only have put in place good CG standards consistent with the national company codes, and more importantly are enforcing these standards, including by imposing sanctions for noncompliance.

In principle, CG also applies to SMEs. However, national codes and standards need to be streamlined and simplified to take into account the limited capacity of these firms. CG in SMEs is generally lacking and supervision and enforcement is much more problematic because there is usually no specific institution empowered to oversee them. As in the case of larger enterprises, SMEs need to improve CG regarding transparency, disclosure, and accountability in order to increase their ability to access to finance. This is particularly the case regarding family-owned businesses where there is a great reluctance to disclose financial information and/or be open to challenging the strategic and financial decisions taken by the controlling party. Good CG practices can also instill better management practices, stronger internal control, and a better strategic outlook through the use of a diversified board of directors.

Addressing deficiencies in corporate governance will therefore require a concerted effort on the part of RMCs, firms, business associations, and development partners. At the government level, RMCs need to: (i) customize existing international guidelines to their particular context; (ii) comply with the recommendations of the APRMs on corporate governance in individual countries; (iii) simplify and extend their national codes to include small and medium-size enterprises; and (iv) place priority focus on strengthening institutional capacity regarding compliance, oversight, and enforcement.

At the firm level, corporations should: (i) adopt the corporate governance principles in national company codes and embed them into their operational practices, (ii) produce and publish their financial statements in a timely manner and, ideally, have them audited both internally and externally; (iii) appoint a diversified set of Board directors, including independent directors, and ensure that they are properly trained regarding their roles, including the protection of minority shareholders' rights.

Business, trade, and other associations can play an important role in this regard by: (i) setting up participatory processes aimed at drawing up codes or charters of ethics to be distributed and implemented at all company levels; and (ii) raising awareness of business ethics among the different parties through information campaigns and training programs in partnership with Institutes of Directors, Institutes of Management, and Shareholders Associations.

Development partners can play a critical role in this area by: (i) "leading by example" and requiring private companies to meet basic CG standards before being able to benefit from their support; (ii) providing additional incentives for good CG by offering preferential terms and conditions to companies that exceed these standards; (iii) relying on financial intermediaries to channel and maximize support to SMEs using similar requirements; and (iv) expand support to regional training centers that "train the trainers" of regulators, directors, and managers regarding best practices in CG.

Conclusion

Although there has been good progress in many African countries to align their national legislation with international standards for CG, much more remains to be done regarding implementation and enforcement. Moreover, there continues to be a lack of good financial disclosure, protection of minority shareholder rights, and development of self-mechanisms for self-oversight. There is also a general lack of appreciation of the need for corporate social responsibility, although combined efforts between government and the local business community are beginning to be undertaken to this end. RMC's development partners, including the AfDB, should lead by example and demand that private firms benefiting from their financial and technical assistance should comply with minimum CG standards and norms and reward them with better terms and condition to the extent possible. This should also apply to the development financial institutions that act as intermediaries between donors and the private sector. The APRM has placed an important spotlight on CG practices in African countries and it is hoped that as the process continues-both with reviewing new countries and following up on previous reviews – there will be marked signs of progress.

Annex 7.1: Summary of the African Peer Review Mechanism Findings on Corporate Governance for Selected African Countries

Algeria: The Algerian government had signed and ratified a number of Corporate Governance codes in line with international standards, although progress achieved so far in terms of implementation and compliance has been insufficient. Public corporations and large private corporations generally comply with existing laws on the protection of labor law, social responsibility, and the implementation of environmental standards. By contrast, many SMEs-most of them family-owned businesses-are less compliant. Most Algerian corporations have not yet developed adequate internal systems for providing information to their trading partners or shareholders. The provision of financial information, even for shareholders, is rare except in the case of public corporations, where oversight by the supervisory authority is highly developed. Most of the shortcomings observed are due to the dearth of qualified accountants. As regards the accountability of corporations and their directors and management, although the legislative and regulatory texts spell out their respective duties, many heads of public corporations claim the right to take management decisions without risk of criminal sanctions for mistakes made in the daily management of the corporation when these decisions are taken in good faith.

Benin: Although the Benin authorities have ratified most of the international conventions related to corporate governance standards and codes, they have fallen short with regard to implementation. The current business climate is still perceived as not being conducive. The majority of enterprises considers the judicial system to be inefficient and ineffective and, hence, prefer to settle their cases out of court. This lack of confidence in the legal system also leads companies to only partially fulfill their statutory obligations to their various stakeholders. For instance, tax evasion is rampant, only a small percentage of employees are covered by the social security system, and the notion of corporate social responsibility is not widespread. As for business ethics, there have been several notable cases of embezzlement of public funds, but few ended-up with stiff sentences. The lack of transparency in formal sector enterprises, governance problems involving state-owned enterprises, and a limited chartered accounting profession in the country raises further challenges for the provision of reliable accounting and financial information.

Burkina Faso: Although Burkina Faso has ratified a number of codes and standards on corporate governance, the dissemination and implementation of these codes and standards remain problematic. The economy is characterized by a large informal sector and is dominated by small and family-owned enterprises which face challenges in accessing bank credit, let alone resources through the stock market. Burkinabe enterprises report weaknesses in the country's justice system and the embryonic state of arbitration and inefficiencies of the courts constitute key obstacles to enterprise development. Except for a few cases, enterprises in Burkina Faso have little sense of corporate social responsibility with regard to environmental management, energy conservation, waste management, and protection of water, soil and air quality.

Ghana: Despite recent efforts aimed at promoting favorable business environment and encouraging corporate bodies to be more transparent, the Ghanaian authorities continue to face challenges in connection with the country's corporate governance policy framework and its enforcement and compliance practices. Awareness of corporate governance, in general, and of corporate social responsibility, in particular, is low. The institutions that are active in the promotion of good corporate governance are weak in financial, human, and institutional terms. This has translated into weak enforcement and implementation of key

codes and standards, most notably the National Accounting Standards. Moreover, although shareholders rights in general are well observed and shareholders are equitably treated under the law, the level of awareness of the various rights is low and most Ghanaians would rather be "out of pocket" than go through the lengthy and expensive court system. Finally, non-owner stakeholders, including employees, complain of limited access to company information.

Lesotho: Although Lesotho subscribes to a number of the international and regional standards and codes for corporate governance, implementation has been lacking. For example, the legal and regulatory framework governing business activities includes a number of statutes, but there is no national corporate governance code. This in part reflects the low level of public awareness regarding matters of corporate governance and corporate social responsibility. Besides perceived delays in legislative action, other constraints include weak property rights, delays in commercial dispute resolution, and problems accessing finance. The labor laws are robust, but enforcement is lacking. Other shortcomings include a lack of protection of shareholders', consumer protection, and intellectual property rights and weak accountability of corporations, directors, and officers. Although a number of corporation have put in place social responsibility programs, CSR is still widely viewed as philanthropic.

Mali: The Malian authorities have subscribed to a number of international codes and standards, but they have not followed up on their ratification and adaptation to the local context. Business managers lack confidence in the legal system due to the lack of clarity of the rules and weak enforcement of court decisions. Moreover, firms often complain about inequality of access to information on the business environment and an overly burdensome tax system which gives provides incentive to operate informally. Companies in Mali recognize the importance of CSR, as a large numbers of firms believe that industrial pollution is the main business constraint. Finally, employees are not always protected by the legal text, as there have been a number of discretionary actions taken whereby employees were declared redundant without any compensation.

Nigeria: The Nigerian authorities have made notable efforts to improve CG. The Nigeria Code of Corporate Governance for public liability companies was developed in 1993 through a joint effort of the Securities and Exchange Commission (SEC) and the Corporate Affairs Commission (CAC). The Committee on Corporate Governance of Public Companies in Nigeria was also established in November 2003 with a mandate to identify weaknesses in CG practice in Nigeria and to implement changes that would align these practices with international standards. Nevertheless, CG remains relatively new and sensitization programs have yet to be undertaken, with only 40 percent of the companies having adopted corporate governance codes. Awareness among banks and listed companies is better than among smaller enterprises, mainly on account of joint effort by the Central Bank of Nigeria and the SEC to promote good CG. However, their regulatory functions of oversight and enforcing sanctions are limited. The CAC's supervisory capacity is also weak and stakeholders rarely use it to investigate a company's affairs. Moreover, judicial remedies are inadequate and corruption is a key factor deterring the effective enforcement of relevant laws. Generally, corporations are failing in terms of disclosure and reporting, partly because of an inadequate regulatory framework for accounting and auditing. Finally, corporate social responsibility is also not well understood and is widely seen more as a philanthropic gesture than as an attribute of corporate citizenship.

Rwanda: CG is fairly new in Rwanda. There is no capital market, the private sector is in its infancy, and the state until recently was widely involved in producing and providing economic essential services. The country still lacks the key institutions of CG, such as

chambers of commerce and industry or genuine regulatory, supervisory oversight bodies, including an institute of directors and professional associations. Although Rwanda has ratified or adopted a significant number of key international standards and codes in CG, there is an overall lack of awareness and country would benefit from proceeding with a large consultation to formulate a comprehensive strategy on CG. Although a regulatory framework for promoting good CG in Rwanda exists, much remains to be done to establish and enforce these legislative obligations and duties, as well as update and expand them. The country's commercial law clearly establishes the role and responsibilities of corporate boards and management. However, specific training sessions for directors and managers need to be designed with the Human and Institutional Capacity Development Agency, the National University of Rwanda, the School of Finance and Banking, and other private sector entities. The accounting plan currently used by Rwandan corporations is not compliant with the International Accounting Standards and the International Standards on auditing are not largely applied by corporations. It is hoped that when created, the Rwandan Institute of Certified Accountants will contribute to the revision of the accounting plan, the training of local accountants, and the sensitization of corporate managers, directors, and shareholders to the usefulness of auditing practices.

Uganda: Although there has been some good progress in CG in Uganda, there are still a number of shortcomings that need to be addressed. Current laws are not fully aligned with international standards and political interference in the administration of justice, compounded by pervasive corruption, has undermined the Ugandan investment climate. Corporate financial transparency is largely lacking with the exception of banks, insurance, and listed companies. Also, despite commendable progress made in strengthening systems for commercial and labor dispute resolution, the judiciary remains plagued with backlogs. In addition, the supervisory and regulatory bodies face critical shortages of human, technical, and financial resources which render them ineffective. In this context, a number of private institutions have been created (i.e., the Institute of Directors, the Shareholders' Association, etc.) with a view to improve accountability and strengthen corporations and their directors and management. Notwithstanding, these institutions lack sufficient resources and need to also expand their coverage to include public awareness on the importance of corporate social responsibility.