The Silent Features

Of

Corporate Governance

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Corporate Governance

Outline

Corporate Governance – Meaning

Why Corporate governance

- Current thrusts
- Framework; Roles; key features and pillars
- Theoretical basis and duties of directors

Corporate Governance - Meaning

- the system by which business corporations are directed and controlled – Sir Cadbury
- specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders - IFC
- spells out the rules and procedures for making decisions on corporate affairs - IFC
- provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance – OECD

Why Corporate Governance

- **Efficiency**: Promote the efficient use of resources
- **Trust:** Promote the trust of investors
- **Correlation:** CG positively linked to performance
- **Link:** between capital flow and CG

CG current thrusts

- Rise of financial scandals and crisis
- Loss of trust of investors even with most trusted entities like Auditors, Security exchange, etc
- Increase in cross-border investment activities.

CG Current thrust

- Investors avoid to invest in countries/companies that are corrupt, susceptible to to fraud, mismanaged and lack protection of investors interest
- Company law and Security market legislation are not adequate and CG supports the legal structure

CG other key roles

- CG’S role is significant in upholding corporate integrity and mitigating risks of corporate fraud, misconduct and corruption

Key features
Corporate Governance

1. Ensuring the basis for an effective corporate governance framework
2. The rights of shareholders and key ownership functions
3. The equitable treatment of shareholders

Key features - Corporate Governance

4. The role of stakeholders in corporate governance – AGM

- Receive performance report
- Appoint new board/ fill vacant position of directors
- Receive Audit Report
- Appoint Auditors
- Declare dividend

5. Disclosure and transparency – Big Issues

- Going Concern (Liquidity, Solvency, profitability, legal compliance)
- Change
- Risks
- Policy
- Risks … etc

6. The responsibilities of the board

- The corporate governance framework

Board Governance Framework

Shareholders

Chairman

Board Meetings

Corporate Secretary

Reporting & Disclosure

Board of Directors

- Achievement of strategic objectives and value creation
- Fulfil responsibilities and duties in law and prescribed functions

Board Operations

Strategy

Corporate Policies & Procedures

Board Governance Instruments

Monitoring and Evaluation

Key Areas of Responsibility

Information and Communication

Governance System and Controls

Board Committees

Audit & Risk Committee

Executive Committee

OHS Committee

CEO & Management

Other Committee

Internal Controls & Assurance

Combined Assurance Model

Internal Audit

External Audit

Other Assurance Providers

Management

Regulators (BOT; BRELA; CMSA/DSE; NBAA/IFRS)

Best Practices:

Four Pillars
of Corporate Governance

- Accountability

- Fairness

- Transparency

- Independence

Accountability

- Ensure that management is accountable to the Board

- Ensure that the Board is accountable to shareholders

Fairness

- Protect Shareholders rights
- Treat all shareholders including minorities, equitably
- Provide effective redress for violations

Transparency

Ensure timely, accurate disclosure on all material matters, including the financial situation, performance, ownership and corporate governance

Independence

- Procedures and structures are in place so as to minimise, or avoid completely conflicts of interest

- Independent Directors and Advisers i.e. free from the influence of others

Role of the board - Part I: Stewardship of the organisation

A. Understanding and influencing the business
B. Overseeing management plans and programmes
C. Guiding and supporting the CEO
D. Providing leadership to the Management and staff
E. Guarding against role conflicts
F. Guarding against interfering in management

Role of the Board - Part II: Representation

A. Advocating its interests in Government circles
B. Shielding it from hostile/negative forces
C. Representing its interests amongst key stakeholders
D. Projecting its image to the public at large

Theoretical framework

- CG quick spread in different parts of the world fuelled by different circumstances leading to different CG frameworks
- The concepts of CG are rooted in Agency Theory (AGT) and Stewardship Theories have been popular since 1980' influencing conduct of organizations in countries that followed civil law.

Theoretical framework

- AGT – firms are exposed to two agency problems (adverse selection; moral hazards) superior information available to professional managers allows them to gain advantage over owners of firms.

Genesis of CG

- Managers will not act to maximize returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders.

Genesis of CG

- The stewardship theory suggests that a firm's board of directors and its CEO, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests.

Genesis of CG

- The AGT promoted the setting up of rules and incentives to align the behaviour of managers to the desires of owners

Genesis of CG

- The stewardship theory (ST), also known as the stakeholders' theory, argue that organizations serve a broader social purpose than just maximizing the wealth of shareholders.
- The stakeholders' theory holds that corporations are social entities that affect the welfare of many stakeholders where

Genesis of CG

- stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives
- Stakeholders can be instrumental to corporate success and have moral and legal rights and when they get what they want from a firm, they return to the firm for more.

Genesis of CG

- Therefore, corporate the conduct business responsibly towards the stakeholders
- Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts

Board of Directors

- Assume responsibility of leadership and control of the corporate
- Direct and supervise the corporate’ s affairs
- Make decisions in the interests of the corporate

Board of Directors

- Regular meetings
- Active participation
- Freedom to include items in agenda
- Sufficient notice for board meetings
- Access to advice and services of company secretary and independent professional advice

Board of Directors

- Full record of board/committee minutes, and available for inspection
- Declare/Abstain from voting if conflict of interest exists
- Insurance coverage in respect of legal action against directors

Chairman and CEO

- Segregation of the management of the board and the day-to-day management of the corporate’s business
- Balance of power at board level to avoid concentration of power in a single individual

Chairman and CEO

- Separation of Chairman and CEO
- Clear division of responsibilities between Chairman and CEO laid down in the Charter

Chairman

- Provide leadership for the board
- Ensure the board works effectively and discharges its responsibilities
- Ensure good corporate governance practices and procedures are in place
- Ensure all directors are properly briefed on 'Matters arising' at board meeting
- Responsible for ensuring appropriate information received by directors

Chairman

- Encourage full and active contribution to the board's affair
- Ensure effective communication between board and the shareholders
- Ensure constructive relationships between executive and non-executive directors

Board Composition

- Balance of skills and experiences
- Balanced composition of executive and non-executive directors
- Non-executive directors should be of sufficient calibre
- Independent non-executive directors should be expressly identified
- List of directors updated and their respective role and function identified

Appointment, re-election and removal of directors

- Formal and transparent procedure for appointment
- Succession plan
- Re-election at regular intervals
- Proper explanation for resignation/removal of directors

Appointment, re-election and removal of directors

- Specific term for non-executive directors
- All directors subject to retirement by rotation at regular interval
- Nomination committee formed to make recommendation on appointment of directors and succession planning for directors, chairman and CEO

Responsibilities of directors

- Keep abreast of the responsibilities as a director
- Exercise duties of care, skill, integrity and diligence expected
- Ensure proper understanding of the operation, business and the regulatory requirement
- Contribute sufficient time and resources to serve the corporate
- Attend AGMs to share the views of shareholders

Non-executive directors

- Active participation in board meetings
- Bring in independent judgment
- Take lead if conflict of interest arise
- Serve on committees
- Monitor the corporate’ s performance in achieving pre-set goals

Information access by directors

Directors should be provided with accurate and appropriate information in order to make informed decision and to discharge their responsibilities

Information access by directors

- Agenda and board papers should be sent in full in a timely manner to directors
- Information supplied must be complete and reliable
- Directors should have access to the senior management for information
- Information supplied should be of form and quality to facilitate informed decision

Remuneration of directors and senior management

- Transparency of directors' remuneration policy
- Remuneration should be sufficient but not excessive
- Each director not to involve in deciding his/her own remuneration

Remuneration Committee

- Remuneration committee to be formed, mainly from non-executive directors
- Consult Chairman/CEO if needed
- Access to professional advice, market comparable information
- Make recommendation on policy and structure of remuneration
- Determine specific remuneration packages of all executive directors and senior management

Remuneration Committee

- Review and approve performance-based remuneration
- Review and approve compensation arrangement in connection with loss or termination of office, dismissal or removal of directors for misconduct

Accountability and Audit – Financial Reporting

- Management provide explanation and information to the board to enable them to make informed assessment of financial and other information
- The board should present comprehensive assessment of the corporates performance, position and prospects in annual and interim reports, price-sensitive announcements and other financial disclosures

Accountability and Audit – Internal Control

- Ensure the maintenance of sound and effective internal controls to safeguard assets
- Conduct regular reviews of the effectiveness of the internal control system, covering financial, operational, compliance and risk management control functions
- Prevent fraud, corruption, and malpractices

Audit Committee

- Have clear terms of reference
- A formal and transparent arrangement to apply the financial reporting and internal control principles and maintain appropriate relationship with external auditors

Audit Committee

- Full minutes of audit committee to be kept
- Provided with sufficient resources to discharge its duties
- Independent from external auditors

Audit Committee

- Make recommendation for appointment and removal of external auditors
- Monitor the effectiveness of the audit process, ensuring auditor's independence and objectivity
- Monitor the integrity of the financial disclosures
- Oversight of the financial reporting and internal control procedures

Delegation by the Board

- Formal schedule of matters specifically reserved to the board for decision
- Clear directions to management as to matters requiring board approval before decision made

Delegation by the Board

- Clear directions to the delegation of the management and administration functions as well as the powers of management
- Review the arrangement for segregation of duties between board and management regularly
- Board Committee to be formed, with specific terms of reference, as needed

Communication with Shareholders - Effective communication

- Maintain on-going dialogue with shareholders and make use of annual general meetings or other general meetings to communicate with shareholders
- Transparency in corporate governance practices and business performances through proper and adequate disclosures
- Encourage shareholders' participation

Communication with Shareholders - Effective communication

- Separate resolution for each separate issue
- Chairman of the board and chairman of each board committees be present in general meetings to answer questions at any general meeting
- Chairman of independent board committee be present to answer any questions in any general meeting to approve transaction requiring independent shareholders' approval

Communication with Shareholders - Voting by Poll

- Inform shareholders about procedure for voting by poll
- Ensure proper compliance to regulatory requirement about voting by poll

4. Fiduciary Duty

- How do we provide leadership that enhances Fiduciary duties fulfilled?
- To accept directorship….. is to accept…. *a responsibility of utmost trust, faith and confidence to manage and protect property or money wherein one person has an obligation to act for another's benefit*

Fiduciary Duties of Board of Directors

Duty of Due Care - determines the manner in which directors should carry out their responsibilities. Failure to uphold the set stipulations may constitute a breach of the fiduciary duty of care of expected directors

Duty of loyalty - requires directors to refrain from pursuing their own interests over the interests of the company

Duty to promote success – directors should act in a good faith and promote the success of the company to benefit of its shareholders and other stakeholders. Includes: approving the establishment of strategic goals, objectives and policies that promote enduring shareholders value as well as protect existing value

Duty to exercise due diligence, independent judgment, and skill - directors should be knowledgeable about the companies' business and affairs, continuously update their understanding of the company activities and performance, and use reasonable diligence and independent judgment in making decisions

Duty to avoid conflicts of interests - potential conflict of interest may occur when director: receives a gift from a third party he is doing business with, either directly or indirectly enters into a transaction or arrangement with that company, obtains substantial loans from the company, or engages in backdated stock options

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Fiduciary Duties and Business Judgment Rules - directors operate under a legal doctrine called “business judgment rules”. Under that law directors that make decisions in good faith, based on rational reasoning, and an informed manner can be protected from liability to the company’s shareholders in the ground that they appropriately fulfilled their fiduciary duty of care

Pertinent questions in Tanzania

- How do we get directors?
- How do we ensure ethical conduct?
- Effectiveness: Attendance & Contributions
- How to manage agency problem and associated risk
- Do we do self evaluation?

Control Environment

- PPRA…. Sidelined the BOARD
- Managing the External Auditor
- Audit Committee not very strong
- Uniformity Vs Independence on roles, rights, privileges and Involvement of Ministers./PS

Should or shouldn't't’t CEO be a board member

- In some boards, the CEO sits inside the board.
- In some, he/she is outside the board
- What is the ideal practice?

Ahsante

Discussions, Q & A