CREATING VALUE FOR SHAREHOLDERS: THE ROLE OF THE BOARD IN ORGANIZATIONAL PERFORMANCE

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

4TH ANNUAL GOVERNANCE & ETHICS CONFERENCE

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Outline

- Relationship between corporate governance and performance
- Introduction
- Board performance and shareholder value under the Corporate Governance Code
- Companies Act, 2015
- How can shareholder value be enhanced?
- Conclusion

Corporate Governance

- Corporate governance:

"The process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability with the **ultimate objective of realizing long-term shareholder value**, whilst taking account of the interests of other stakeholders."

Corporate governance and performance

- Research has established that corporate governance is critical for the performance of companies and the enhancement of shareholder value (IFC, OECD).
- Some of the research findings include-
  - Strong corporate governance leads to good performance and shareholder value
  - Companies with strong corporate governance are less risky and have higher dividend pay-outs
  - Corporate governance increases the confidence of local and foreign investors
  - Corporate governance enhances access to capital, mitigates risk and safeguards against mismanagement
  - Improved corporate governance contributes to the development of the private and public capital markets

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Corporate governance and performance

- Investment in good corporate governance leads to better operational and market results (IFC)
- Research in Latin America compared companies with good governance practices with those that did not and found the following-
  - Companies with good governance practices had 21.7% return on equity and 34% profit pay-outs compared to 16.7% and 11% respectively for those that did not invest in good governance
  - Other findings showed that investment in good governance resulted in better liquidity, market capitalization. Dividend yield and financial leverage

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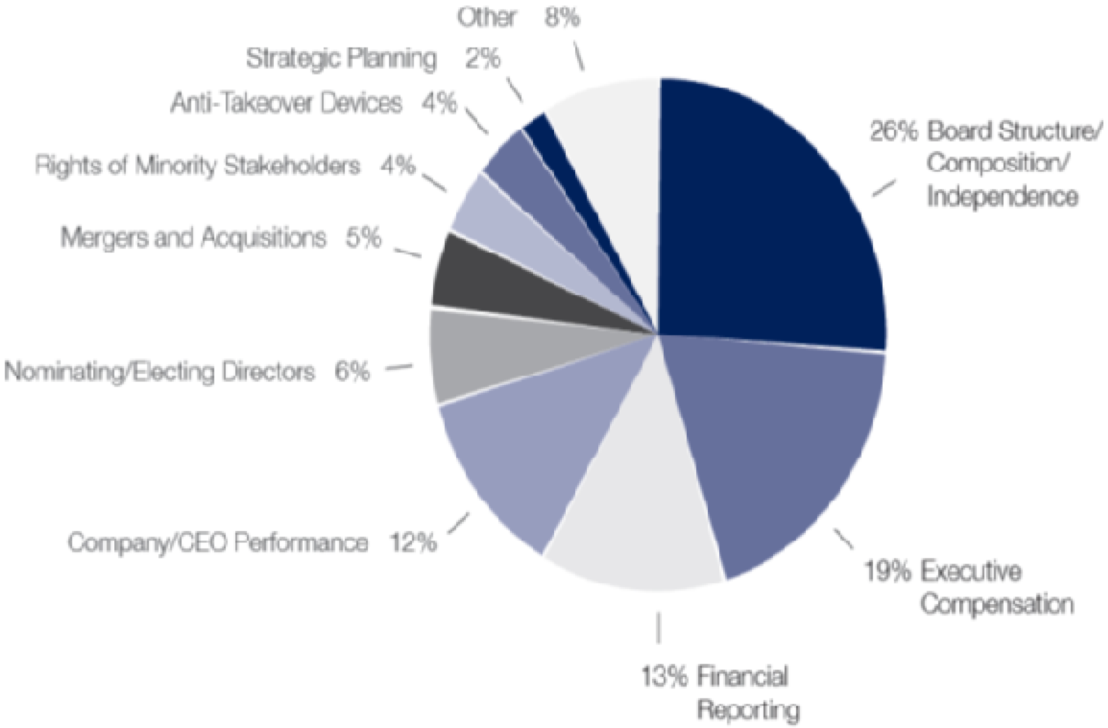
Board structure and independence critical



Source: RiskMetrics Group, Inc.

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Introduction

- Corporate governance is an essential factor for determining performance and shareholder value
- Capital Markets Master Plan (2014-2023) underscores the central importance of sound corporate governance to attractive financial market
- Companies Act enacted in September 2015 reinforced new requirements for directors
- Code of Corporate Governance for Issuers of Securities to the Public, 2015 gazetted seeks to enhance the long-term success of companies
- Amendments to the Public Offers Regulations establish mandatory corporate governance requirements
- Stewardship Code for Institutional Investors provides for more engagement between institutional investors and investee companies.

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Corporate Governance Code

- The Corporate Governance Code is a product of a multi-stakeholder engagement processes that begun in 2012
- The Code was gazetted on March 4, 2016
- The Code sets out principles and specific recommendations that companies should adopt in making good governance an integral part of their dealings and culture
- The Code is on 'Apply or Explain' approach which is principles based and caters for differential application
- Mandatory provisions of Code incorporated into the Public Offers Regulations that were gazetted on March 11, 2016
- Some of the mandatory provisions include requirements on
  - board diversity,
  - transparency,
  - nominating committees,
  - limits on directorships, among others

Corporate Governance Code

- Apply or Explain' approach – It takes into account different business structures and scope for Code compliance
- The Board must explain any deviation from recommended practice and give a satisfactory explanation to the stakeholders including the Capital Markets Authority and shareholders
- Companies are required to provide a clear roadmap, acceptable to CMA, to move towards full application in the event that the deviation delivers a lower governance standard
- The Code sets out key corporate governance requirements for listed companies so as to enhance sustainable companies and shareholder value

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Stewardship Code

- The Corporate Governance Code recommended the development of the Stewardship Code for Institutional Investors
- The Stewardship Code was developed through stakeholder committee and is now awaiting gazettement
- The stewardship Code encourages deliberate and responsible management and oversight of assets by institutional investors through engagement with listed companies
- Seeks to ensure that institutional investors foster sustainable value, wealth maximization and long term success of investee companies
- Promoting transparent, honest and fair dealings in the companies in which institutional investors participate
- The Code seeks to ensure that the shareholders receive maximum value for their holdings through engagement with investee companies

Companies Act, 2015

- The Companies Act introduces requirements for company directors to promote the success of the company for the benefit of its members
- Section 143 requires directors to have regard to-
  - Long-term consequences of any decision of the directors;
  - The interests of the employees of the company;
  - The need to foster the companies business relationships with supplies, customer and others (sustainability)
  - The impact of the operations of the company on the community and the environment; (environment)
  - The desirability of the company to maintain a reputation of high standards for business conduct; (governance)
  - The need to act fairly as between the directors and members of the company
- These requirements call for greater oversight and control by directors

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How can shareholder value be enhanced?

- Board composition and diversity
  - Boards be constituted in a manner that ensures effectiveness and value addition
  - Boards with appropriate balance of skills, experience, independence and knowledge be appointed
  - Studies have found that diversity affects operating performance of the board and contributes in improving the quality of governance (Italy)
  - Companies with diverse boards enjoy 14% higher earnings and 53% greater returns on equity (McKinsey, 2012)
  - Companies with one or more women on the board deliver higher returns on equity, better average growth and higher price values (Research Institute)
  - Diversity helps promote sustainability of business and the economy

How can shareholder value be enhanced?

- Remuneration of directors linked to corporate performance
  - Ensures maximization of shareholder value
  - Ensures that appropriate incentives are set out based on performance
- Effective stakeholder relations
  - Effective management of stakeholders positively impacts a company’s strategy and long-term growth
  - Stakeholders include shareholders, customers, suppliers, employees, creditors, regulators, media, auditors and potential investors
  - Board to recognize the rights of stakeholders and encourage co-operation in creating wealth and sustainable businesses

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Corporate Governance Code

- Focus on sustainability
  - Ensures that the company is able to conduct its operations in a manner that meets existing needs without compromising future needs.
  - Board to ensure that the company's strategies promote sustainability
  - Key considerations be on environmental, social and governance (ESG) matters
  - Sustainability promotes long-term success leading to increased shareholder value
  - Integrated reporting a useful tool for reporting on the company's sustainability strategies
- Governance and legal audits
  - Corporate Governance Code requires companies to undertake governance and legal audits annually
  - Audits key in checking the level of compliance with the law and sound governance practices

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Conclusion

- It is evident that ethical governance, organizational performance and shareholder value cannot be achieved without the concerted efforts of all stakeholders
  - Board, management, employees, government, creditors, auditors and the society are critical stakeholders
- The audit / accounting profession has a great role to play in ensuring that companies adhere to the corporate governance requirements

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Recommendation

- Audit profession to be play a greater role in ensuring that companies adhere to corporate governance requirements
- Auditors to advise clients on the importance of corporate governance and ethics
- Audit needs to advise boards on significant risks and exposures that requiring disclosure
- Disclosure of Key Audit Matters
  - Public responsibility elevated against the contract with the client)

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THANK YOU

QUESTIONS?