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

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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
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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
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
Board structure and independence critical

Source: RiskMatrices Group, Inc.
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.
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
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 gazettlement
- 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
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.
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 cooperation in creating wealth and sustainable businesses
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
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
Recommendation

- Audit profession to 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 require disclosure
- Disclosure of Key Audit Matters
  - Public responsibility elevated against the contract with the client)
THANK YOU

QUESTIONS?