## INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

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### EMBRACING CORPORATE GOVERNANCE AMONG LISTED ENTITIES: VIEWS & PERSPECTIVES OF CAPITAL MARKETS AUTHORITY

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I am pleased to join you today in this Conference aimed at sharing views on harnessing competitive advantage through sound corporate governance and ethics. This is a big subject to restrict to a few minutes. I will however attempt and share some perspectives on application of corporate governance and especially on listed/public entities.

Corporate governance (CG) is how an organization is led, directed, managed and controlled. It is almost universal that successful entities with multiple shareholders or shared management responsibilities will have a set of rules and practices of doing things that make them that successful. Ethics support good corporate governance but elaborate CG provides far greater assurance and predictability to an organisation.

Evolution of CG has over the last 50 years been catalyzed and accelerated by fragmentation of ownership, greater incidence of separation of ownership and control; and the creation of significant classes of passive shareholders. These factors have themselves led to the phenomenon that is famous with students of Economics, the Agency problem, and its attendant risks and costs kicking in as a necessity. You have managers who are not owners, some passive minorities that need to be protected, communities that need care, a fragile environment, institutional investors that are too big to possibly care about relative small investment that are several hundreds of millions in value, Boards that must be accountable, and risks that must be calculated and managed.

The key principles of corporate governance include: Integrity with independence; Equity with fairness; Authority with responsibility; Actions with Accountability; Performance with Conformance; Conduct with Discipline; Profitability with Sustainability; and Communication with Transparency.

Best CG practice is therefore not theory but an engrained practice. It is embedded in the culture of an institution. It is not a reserve for the board but pervades into the entire organization including management, employees, shareholders and stakeholders.

Let me give you a flavor from my favorite story on CG. My first encounter as a trainee with what I later realized was a fundamental in corporate governance was in an entity that categorically stated (to paraphrase): we have a standard of doings around the world, we are happy with it and we shall abide by the law; however, should the law require less our standard shall prevail, and if it shall be that we lose business for upholding our values that will be acceptable a price to pay. You will not imagine how empowering that knowledge was that no one in the organisation would be compelled to commit an illegality or use a short cut. In the whole the organization created a battalion of guardians and protectors of its values and business. Those values have percolated through many entities over the years. I felt the loss when after many decades the entity quit this market, your guess is as mine on some of the reasons for that action. It is therefore very difficult to separate good CG from ethical principles.

To guide organizations in setting up their governance structures, countries often develop codes, guidelines or regulations.

In our case in Kenya, the Code of Corporate Governance for Issuers of Securities to the Public 2015 was gazetted on March 4, 2016 and become effective a year later on March 4, 2017. This Code is applicable to all issuers of securities to the public.

Why does corporate governance matter? The introduction of the Code was made necessary by the need to address systemic corporate challenges in Kenya, respond to corporate governance gaps, align our laws and regulations to better practices elsewhere and improve corporate governance capacity among our listed companies. Even more importantly we need it as we aspire to make Kenya the desired investment destination regionally and globally. (I am careful with the use of International Standard because I also believe that the Women and Men here can device and drive best practices for replication across the globe). The Code seeks to make good corporate governance an integral part of an issuers' business dealings and culture. Challenges that have faced some of our listed companies are attributable to governance. On the other hand, companies that have been successful and sustainable have strong governance practices and strategic boards that think ahead without losing control – they are responsible and don't easily drive into hazards.

The Code contains six essential components which if implemented will effectively promote sustainability and investor confidence, reduce risk and increase profitability of the companies. These components are-

(a) Board operations and control;

(b) rights of shareholders,

(c) stakeholder relations;

(d) ethics and social responsibility;

(e) accountability, risk management and internal controls;

(f) transparency and disclosure.

These chapters form the bedrock of an effective corporate governance framework.

An effective Board is a primary driver of good corporate governance in our companies. The way company goals, policies and strategies are set, operations and management overseen and company is run on a day to day basis are critical determinants of the company's success. It is now a global practice incorporated in our CG Code that there should be separation of roles of management and the Board for a more effective and efficient functioning of an organization. The Code recognizes the role of a non-executive chairman in providing leadership.

The effective leadership and ethical management of an organization relies heavily on the effort of the Board, management, shareholders and stakeholders: a shared responsibility.. The composition of the board members ought to reflect diversity in age, skills and competencies as well as independence. Board composition that reflects diversity helps in infusing competencies, experiences and professionalism. This is the responsibility of shareholders and the board. Ethics is core in the management and leadership of any organization.

The Code has a dedicated chapter on ethics and social responsibility. The key focus is the company as a good corporate citizen, ethical leadership and social responsibility. In addition, accountability, risk management and internal controls are critical especially for auditors. Some of the key provisions in the Code include independent verification of the integrity of financial reporting, rotation of independent auditors every six to nine years, introduction of integrated reporting and recognition and management of risks.

A company also operates in a socio-political and economic environment and must in making its decisions or formulating policies consider the environmental, social and economic impact of its decisions. It must run its activities in an environmentally responsible and ethical manner. This is further in light of our Constitution of Kenya, 2010 which applies to all persons including corporates and espouses horizontal application of rights; including requiring companies to respect, promote, and uphold rights and freedoms in the Bill of Rights.

As a good corporate citizen a company participates in the development and growth of the community in which it operates, listens to them and considers their views in company's operations. Involving the people and communities facilitates ownership of projects and collaboration. A lot more needs to be done in this area with the understanding that medium and small companies have a greater direct engagement with the society than large corporations. Any improvement in their operations would therefore be far reaching. The code is encouraging listed companies to pay attention to their corporate citizenship which, in extreme situations might mean their life or rejection by the host communities.

The auditors on the other hand, must be professional, independent and compliant with the Code and other laws in their reporting obligations and assist companies in moving towards the introduction of integrated reporting. We have no doubt that the ICPAK will be instrumental in ensuring that its members remain professional and competent and will be at the forefront of implementing the Code of Corporate Governance.

I am pleased to report that the Authority is very encouraged that several listed entities have already gone a long way in adopting the new CG code ahead of formal effective date of 4 March 2017. On our part, to support the implementation we have developed a reporting template to be used by companies for their compliance with the Code. We have also developed the CG Scorecard to be used in assessing the level of corporate governance compliance of listed companies. There shall also be governance audits to be carried out by professionally qualified governance auditors accredited by ICPSK for this purpose.

We have lofty aspirations; that corporate governance becomes so pervasive in our markets that investors, shareholders, employees, financiers and other stakeholders can rely on the accountability, performance and conduct of the other. The success and implementation of the Code, however, depends on the willful acceptance and ownership by listed companies, and as I have said the response has been very positive. While the Authority will superintend the implementation process, it will be much easier for the entities that take CG as their own calling and pursuit in building of shareholder value. The Code may not be a panacea for all governance lapses but it sets out practices that if well implemented, stability and sustainability of our companies will be strengthened.

Various studies carried out have affirmed a positive correlation between good corporate governance and performance of companies. Companies which adopt good corporate governance either through better and enhanced shareholder rights, effective and material disclosure or effective board practices have over time reported better return on equity (ROE) or assets (ROA) than those with poor corporate governance (IFC, 2012). Good governance is worth the investment.

Corporate governance is an essential for overall market confidence, the efficiency of capital allocation, the growth and development of a country's industrial bases and ultimately the nation's overall wealth and welfare.

Kenya's vision 2030 includes a vibrant and globally competitive financial sector promoting high levels of savings and financing for Kenya's investment needs. Well governed companies will have a pivotal role in creating the environment for national financial growth.

I ask all of you as Directors and Management practitioners to believe and become disciples of good CG and, take actions that will lead to the recognition of Kenya as a foremost financial success driven by deep rooted governance structures and practices. When that day comes, the credit shall be to our selfless Boards, objective management, ethic based professionals including lawyers, internal and external auditors, valuers and assessors, and all those others whose opinions and actions are relied on by others in their decision making.

We all have a significant part in making Kenya "**The Heart of African Capital Markets."**

I thank you all.

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**DIRECTOR, CORPORATE SERVICES**
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