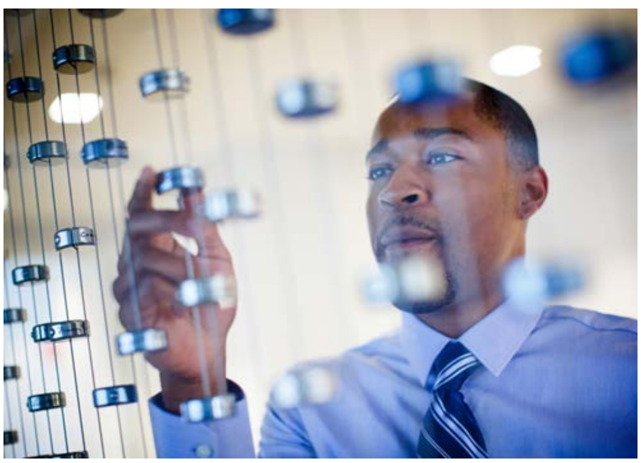
What shareholders need to know about corporate governance reforms

More Kenyans are starting to embrace the financial benefits of investing in publicly listed companies. However, the increase in shareholding also brings with it a greater demand for listed companies to be properly managed. Unfortunately, in the past few years, many Kenyans have lost confidence in boards of listed companies. In some instances, this has been due to fraud or mismanagement often due to poor governance and management of companies. In a span of less than five years, high profile scandals and company collapses have led to massive losses and spelt doom for shareholders in Kenya. In some instances, it took far too long for the fraud and malpractices by management to be discovered. This has raised doubts about boards' effectiveness.

Protecting Kenyan shareholders

These failures, coupled with public outcry, have been followed by corporate governance reforms in Kenya such as those introduced by the Capital Markets Authority in 2016. Most importantly, the CMA's revised Code of Corporate Governance Practices, which applies to all issuers of securities to the public, which was gazetted on 4 March 2016. The Code aligns local standards to global best practice in order to promote institutional strengthening for listed companies.

The Code goes beyond existing legislation by setting out 'principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture.' The Code adopts an "Apply or Explain" approach whereby boards are required to 'fully disclose any non-compliance with the Code to relevant stakeholders including the Capital Markets Authority with a firm commitment to move towards full compliance.'



Companies should also ensure that they fulfil the Code's recommendations on carrying out legal and governance audits annually. This should not just be viewed as fulfilment and compliance with the Code's guidelines as, in the long run, this will be beneficial to shareholders. This will allow boards to spot and mitigate governance risks.

A year on we reflect on some of the corporate governance achievements and challenges since the introduction of the Code.

Board composition

The Code recommends that the composition of a board be disclosed in the company's annual report. In particular, whether at least two thirds of board members are independent and other non-executive directors. This recommendation is intended to bring independent and objective judgment to the board and follows a spate of corporate scandals involving self-interest, related party transactions and nepotism. We are starting to see some progress with Boards putting in place policies on related party transactions and management of conflict of interest. There have also been recent cases where CEOs of publicly listed companies have had to resign due to allegations of related party transactions.

Care and diligence

Another important recommendation is that a director of a listed company shall not hold such a position in more than three publicly listed companies at any one time. Further, a chairperson of a publicly listed company is precluded from holding such a position in more than two publicly listed companies at any one time.

Many publicly listed companies have in the past grappled with the effect of having directors sitting on multiple boards. Some argued that this affected their effectiveness in monitoring and controlling how management ran a company's affairs. Companies no longer need to rely on a small pool of board candidates. Appreciably the skills pool in Kenya has increased over the years. More Kenyans are now better educated and have the experience to sit in boards.

However, another school of thought argues that individuals may need to hold multiple directorships so as to build their reputation and to be more valued in the market. Some may view it as "selfish" for influential individuals to want to hold on to positions of power and control the stakes in Kenya's stock market.

Commendably in the past year we have seen board members also resigning to avoid sitting in multiple Boards.

Accountability

The Code also sets out guidelines for improving accountability, transparency and openness within companies. For example, boards should disclose a company's Code of Ethics and Conduct on their websites as well as the company's annual report. Further, boards are expected to disclose the company's whistle blowing policy in their annual report and website. The main aim of mandating Boards to develop and implement a whistle blowing policy is to ensure that stakeholders are provided with a confidential reporting mechanism and all improper, unethical or inappropriate behaviour are identified. It is an important means of deterring and detecting instances of poor corporate governance.

Compliance

Recently, KPMG conducted an online research to determine whether Kenyan listed companies have adhered to this requirements within the last one year. Out of 65 listed companies surveyed, 59 have websites and only 18 companies have published their Code of Conduct on their websites. 55 companies were found to have published their annual reports and accounts while 29 companies have published their environmental, social, governance policies
and implementation thereof in their annual reports and websites. However only six companies have displayed their Whistle Blowing Policies on their websites. Further, only seven companies have published their Board Charters.
Understandably, full compliance may not be achieved overnight but questions remains as to how regulators will enforce these requirements. Companies had one year to implement the Code or disclose to the Capital Markets Authority the reasons for non-application and indicate the time frame for full application. The CMA has so far reportedly trained 80 Chief Executive Officers and Chief Finance Officers from listed companies on the Corporate Governance Code. In light of these efforts, shareholders can only hope that better equipped and skilled directors will translate to higher returns for them.

Enforcement

The Capital Markets Authority has shown that it is willing and is able to investigate lapses in corporate governance and when appropriate, take enforcement action against company directors. This is a vital step in ensuring that directors comply with their legal obligations. Good corporate governance is not only limited to ensuring that a company is properly managed. It additionally includes investor transparency. Whether it is raising fresh funds from the public or signing off on financial statements, directors are responsible for ensuring that the market is not mislead or deceived.

Good corporate governance

The Organisation for Economic Co-operation and Development recognises that good corporate governance contributes to financial market stability, economic growth, business integrity which is essential for companies that need access to equity capital for long term investment.

But we all know that. The challenge is that we must act on it. In the words of Abraham Lincoln, "I am not bound to win, but I am bound to be true. I am not bound to succeed, but I am bound to live by the light that I have. I must stand with anybody that stands right, and stand with him while he is right, and part with him when he goes wrong." Shareholders have to take governance seriously. Before investing in a company, a shareholder should consider if the board is competent, whether there is diversity in board composition and do the board members have reputable standing. Shareholders should continue to hold directors to account, through annual general meetings.

Board members, on the other hand, need to ensure that they have proper oversight and familiarise themselves with key operations to enable them question management's decisions and recommendations.
In fact, the onus is on all stakeholders: regulators, enforcers, directors, customers, shareholders, investors, suppliers and the government to ensure that corporate governance reforms are implemented and a positive impact is achieved.

Nancy Kanyiri is a Senior Associate in Risk Consulting, Forensic – Regulatory Enforcement & Compliance Services with KPMG Advisory Services nkanyiri@kpmg.co.ke. The views expressed herein are personal and do not necessarily represent the views of KPMG.