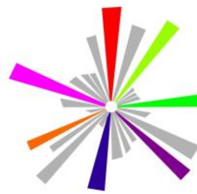

CROSS-CUTTING ISSUES IN CORPORATE GOVERNANCE

INTRODUCTION

In an era of 'open knowledge' and increasing risk awareness, investors now take more interest in the personalities of those who constitute the 'directing mind' of corporate entities as much as in the reputational values of the entities; before staking their moneys. Essentially, this trend is due to a number of large corporate failures witnessed across the globe in the recent past, most of which have been linked to negligent, unethical and unwholesome practices by the top management and board members of affected organizations.

The stories of the collapse in 1992, of two large UK companies; Maxwell Communications and Polly Peck International and about ten years later, of two American corporate giants; Enron Corporation and WorldCom, clearly highlighted the critical importance of corporate governance, for the growth, sustainability and survival of corporate entities.

As measures for preventing a reoccurrence of those gigantic collapses, the "Financial Aspects of Corporate Governance" report (popularly known as the 'Cadbury Report', 1992) was published in the UK while the Sarbanes-Oxley Act (2002) was enacted in the US; introducing fundamental reforms in the management of corporate entities. These measures made far-reaching provisions on the ethical composition of the board and the proper accounting systems to be adopted by companies; so as to mitigate corporate governance risks and failures. Arguably, this report and the law initiated the issuance of Corporate Governance Codes ("CGCs"), in many countries of the world to regulate the effective governance of business and corporate entities.

Whilst there is consensus of opinions among stakeholders across the globe on the importance of corporate governance, discrepancies however remain across jurisdictions as to what should be the form, scope and character of an ideal CGC. In this article, we seek to elevate the discussion around some of the trending issues of corporate governance and analyze their importance within the context of finding workable, streamlined and ethical codes for effective regulation of corporate entities.

THE CORE OF THE MATTER

The Organisation for Economic Co-operation and Development ("OECD"), in its September 2015 publication, the "*Joint G20/OECD Corporate Governance Principles*" (OECD CG Principles), provides that; "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance".

It is common knowledge that the institution and implementation of a good CGC is driven by the Board of Directors ("the board") of a company or an organization. Many believe that the management of organizations cannot be trusted to do justice to the various interests of its stakeholders. Consequently there must be a functional, ethical and effective board that establishes and enforces an ethical corporate culture for the organization. This explains why properly governed companies attract quality investors and countries with effective and well regulated corporate governance codes have stronger economies.

In an *"Investor Opinion Survey on Corporate Governance",* carried out in June 2000 by McKinsey & Co., "over 80 percent of investors say they would pay more for the shares of a well-governed company than for those of a poorly governed company; with comparable financial performance". Evan Harvey, the Director of Corporate Responsibility at NASDAQ, also in a similar vein wrote in the 17 January 2016 Issue of *Ethical Boardroom* (a reputable London-based online global corporate governance magazine) that, "members of company boards have a responsibility to formulate and direct policy that addresses key risks, including the very important one of potential reputational damage."

Therefore, the fundamentals of a corporate governance regime are: institution of a corporate culture for an organization; setting of corporate goals/mission and the mechanism for achieving them; balancing the various stakeholder-interests; incentivizing quality performance, encouraging compliance and building outstanding reputation; protecting the value system and engendering long-term sustainability; as well as enthroning good government in the top echelons of the corporate leadership of the organization.

NIGERIAN LEGAL FRAMEWORK

In 2003, at about the time of the 'birth' of the America's Sarbanes-Oxley Act, the Nigeria's Securities and Exchange Commission (the "SEC"), against the backdrop of widespread erosion of public confidence in corporate entities, issued the **"Nigerian Code of Corporate Governance Practices"** for public companies. The Central Bank of Nigeria (the "CBN") immediately followed suit by issuing in the same year, a **"Code of Corporate Governance for Banks and other Financial Institutions in Nigeria".** These codes have since been reviewed a number of times.

Major reforms introduced by these early codes range from board composition to separation of the office of the CEO from the board chairman; conflict of interests; directors' dealings; creative accounting policies; fixed term of office for CEOs and board members; risk management & disclosure standards; whistle-blowing policies; quality of membership of the audit committee and the establishment and composition of other critical committees of the board.

It is instructive to note, however, that a broad corporate governance framework existed to some extent in Nigeria before the above two early codes. Essentially, 'codes of conduct' for directors of companies were entrenched in the **Companies and Allied Matters Act ("CAMA"), 1990.** The legislation touches on matters of remuneration & payments, disclosure of directors' interests in the company's contracts and

shareholding structure, the duties that directors owe to their companies as legal entities, fiduciary relationship etc. See sections 267 – 292 of the CAMA (now found in Cap. C20, Laws of the Federation of Nigeria 2004).

Apart from the general codes for public companies and banking institutions mentioned above, there are today a couple of sector-specific CGCs in operation in Nigeria. There is also a **"National Code of Corporate Governance"** (still inchoate), which the Financial Reporting Council of Nigeria (the "FRCN"), issued in draft in 2015 to have an all-sector coverage; to govern the private, public, and not-for-profit organizations.

At any rate, the CGCs that are operational in Nigeria at the moment include:

1. Codes of Corporate Governance for Banks and Discount Houses in Nigeria and Guidelines for Whistle Blowing in the Nigerian Banking Industry, 2014 – issued by the CBN
2. Code of Corporate Governance for Public Companies, 2014 – issued by the SEC
3. Code of Corporate Governance for Shareholders Associations, 2014 – issued by the SEC
4. Code of Corporate Governance for Insurance Companies, 2009 issued by the National Insurance Commission
5. Code of Corporate Governance for Licensed Pension Operators, 2008 – issued by the National Pension Commission
6. Code of Ethics and Business Practices for Licensed Pension Operators, 2008 – issued by the National Pension Commission
7. Whistle Blowing Guidelines for Pensions, 2008 – issued by the National Pension Commission

TRENDING ISSUES

Here, we focus on some of the corporate governance issues, which have become topical and occasion varying views among stakeholders, operators, market practitioners and regulators:

<u>Mandatory or Voluntary Compliance?</u>

There has been much debate about whether or not compliance with CGCs should be made obligatory for corporate entities in Nigeria. Evidence-based researches show that substantial compliance with CGCs is better driven by the corporate culture or value system within an organization, than when it is compelled by regulatory imperatives. Therefore, where good governance ethos, ethical norms and best practices have been internalized and absorbed in an organisation, a strong positive culture and reputational strength are established. Accordingly, the CGC becomes not just the rules of engagement but a tool of competitive edge, which elicits automatic compliance by all relevant stakeholders.

Some schools of thought argue that since adherence to good government is intrinsically linked to developing goodwill and hence public trust, brand leadership and success for a company in the long run;

then CGCs need not be enforced. Based on this, they opine that a more flexible "COMPLY OR EXPLAIN" rule should be the principle behind any CGC. However, there are concerns that the 'comply or explain' model will only work in climes where integrity is adequately rewarded and a corporate culture of proper values and ethics prevails over unethical short-term profiteering. In many of today's societies, the 'comply or explain' rule may end up as escape route for companies with no good Environmental, Social and Governance (ESG) policies; to seek to explain away their deficiencies.

An example of a jurisdiction with strong and effective corporate governance culture is the United Kingdom. Even with this high reputation of good governance among the boards of UK companies, the Financial Reporting Council Limited of the United Kingdom (the "FRC UK") in its **"Developments in Corporate Governance and Stewardship 2015 Annual Report"**, published in January 2016, stated that: "There has been a small decrease in the number of companies strictly complying with the provisions of the UK Corporate Governance Code … Given that the principle of 'comply or explain' provides flexibility for companies to depart from a Code provision, it is important that a clear explanation is provided so that shareholders can assess whether they are content with the governance arrangements which the company has put in place".

Invariably, there is consensus of opinion globally in favour of strict compliance with CGCs in the absolutely sensitive and volatile segments of the economy; such as the financial sector. The risk of mismanagement is high and the systemic damage to the overall economy usually virulent, where unethical compromises lead to distress in the banking industry, public pensions, insurance and the capital market.

<u>Any need for a National Code?</u>

As mentioned earlier, the FRCN intends to put in place a one-cap-fits-all approach to corporate governance by issuing later this year 'the National Code of Corporate Governance'. Expectedly, widespread criticisms from various stakeholders have assailed the draft of this document exposed to the public for comments. Questions arise as to whether Nigeria, a developing economy with many fundamental growth-challenges, is ripe for the FRCN's kind of national CGC?

There are also legal hurdles on the way of the national code which the FRCN has yet to clear. The Private Sector Code (PSC) part of the draft national code flies in the face of a Federal High Court judgement per Honourable Justice O. E. Abang in the case of **Eko Hotels Limited V. Financial Reporting Council of Nigeria** (Unreported: Suit No. FHC/L/CS/1430/2012 delivered on 21/03/2014); where it was held that the FRCN's power, as stated in its enabling Act, covers only public interest entities and that this does not extend to regulation of private companies. This decision also holds for the Not-for-Profit entities in Nigeria.

Besides, some provisions of the draft national code contradict the positions in the Companies and Allied Matters Act and certain regulations and guidelines in Nigeria. Given that these currently operational CGCs were issued by the various sector-specific regulators under their enabling Acts, the draft national code therefore amounts to a "re-legislation" of the issues covered in the various relevant Acts and in certain

instances appears to repeal those statutes. It is trite that a subsidiary legislation can neither lawfully amend its principal Act nor repeal any other statute whatsoever.

Even in the UK, where most of the regulations and statutory regimes across industries are streamlined, the FRC UK does not operate a mandatory Code that compels different entities to comply with a unified body of rules without option. The UK Code of Corporate Governance 2014 only serves as a model of good governance principles for UK companies to adopt.

Although there are laudable reasons behind the drafting of the national code by the FRCN, as it ought to be a document streamlining the various CGCs, the document as it is, will create certain compliance difficulties and overburden and over-regulate companies including 'not for profits'. The FRCN should also be more patient and accommodating, and work well with all of the other sector regulators and operators.

And The Board?

Much has been said earlier about the board of directors and its place in the corporate governance framework. According to the SEC's CGC for public companies, the board has vital roles to play in instituting and sustaining a good governance regime:

1. The board is accountable and responsible for the performance and affairs of the company;
2. The principal objective of the board is to ensure that the company is properly managed;
3. The responsibility of ensuring good corporate governance lies with the board;
4. The board must define the framework for the delegation of its authority or duties to management.

In the McKinsey & Co.'s "Opinion Survey" earlier referred to, most of the investors who participated in the survey defined 'a well-governed company' as one "having a majority of outside directors on the board with no management ties; holding formal evaluations of directors; and being responsive to investor requests for information on governance issues…"

Apparently, the practice of separating the board from management is good corporate governance practice. It enhances independent and unbiased assessment of management's performance as well as ensures appropriate board evaluation.

However, opinions differ as to the degree of director independence that is desirable and which enhances best practices. Most CGCs today require that considerable percentage of the members of the board be independent non-executive directors ("INED"). The SEC's CGC defines an INED as "a Director who is not a substantial shareholder of the Company (holds less than 0.1%); is not a representative of a shareholder who has the ability to control Management; had not previously been employed by the Company; is not an immediate family of an individual who is or has been in any of the past three financial years employed by the company; is not a professional adviser to the company other than in a capacity of a director and is not in a significant contractual/business relationship with the Company".

To ensure independence, the FRCN introduced in its draft national code mentioned earlier, the position of "Senior Independent Non-executive Director" – SIND. The SIND is provided for in the UK Code of Corporate Governance but it is unlikely that this will be effectively accepted in Nigeria, since it appears to conflict with certain provisions of the CAMA.

At any rate, a balanced and well-composed board of directors ensures the right mix of corporate governance elements: human capital; technical expertise; checks and balances; proper accounting practice; regulatory compliance; effective board committees and evaluation process; shareholder protection (especially minorities); whistle-blowing mechanism; and ESG policies. However in our considered opinion, independence is a 'state of the mind' and a function of the personal integrity of individual directors. Independence is not an exclusive result of the structure or composition of the board or the prescriptions of codes.

CONCLUSION

Corporate governance in Nigeria, as in the advanced, emerging and other developing countries of the world, is an evolving and dynamic concept. The process of building good corporate culture will continue to attract debates and contributions from various stakeholders until a generally accepted model is attained. Our past experiences of widespread distress in the banking industry and the stock market, linked to unethical insider-related dealings, unhealthy speculation and excessive risk taking; have all made the adoption, compliance and regulation of effective corporate governance regimes necessary for Nigeria. This is even more imperative as the government encourages domestic investors and also seeks to attract foreign (direct & portfolio) investors into the country. Regulators, corporate entities with their managements and boards, shareholder groups and other professional bodies must all put their hands on the plough.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo

DISCLAIMER: This article is only intended to provide general information on the subject matter and does not by itself create a client/attorney relationship between readers and our Law Firm. Specialist legal advice should be sought about the readers' specific circumstances when they arise.