An Overview of Corporate Governance in Africa

Friday Audu Ph.D1, Isyak Ibrahim Ogirima2 & Siyaka A. Rahanatu3

1&3- Department of Accounting,Faculty of Management Sciences,
Kogi State University Anyigba – Nigeria.
2-Department of Public Administration,Faculty of Management Sciences,
Kogi State University Anyigba – Nigeria.

ABSTRACT

This paper titled: "An overview of corporate governance in Africa" tries to address whether the African countries, which currently have a corporate governance code in place, have acknowledged their specific context and environment in developing their own corporate governance codes. According to many researchers, there are no universal laws in corporate governance and the efficiency of specific corporate governance practices can vary in different contexts. The researcher applied archival research techniques to analyze the national corporate governance codes of each country. This has enabled an analysis of multiple countries simultaneously and also a comparative analysis of older and newer codes of the same country. The findings conclude that African corporate governance codes have not merely been mimicked from their colonizer's code, but rather African countries have in their codes addressed issues which are relevant for their environment, such as strong communal values and corruption. However, the codes still have room for improvement in relation to minority rights protection and in the encouragement of institutional investor participation for example. The study found that those African countries which have a corporate governance code in place are on average less corrupt than the countries which do not have such code in place at the moment.

Keywords: Corporate governance, Agency theory, Corruption, Colonialism, Africa

1.1 Introduction

There is a growing consensus that corporate governance has a positive relationship with national growth and development of economy. The financial crisis and the following collapses of major institutions have brought more attention to the need for effective and good governance methods both in developed and in developing markets. This study aims to compare the differences and similarities between African countries' national corporate governance codes with European national codes.

The major part of the study is a comparative analysis between the various African country codes and their historical colonizing powers. The objective of this part of the study is to find out, how similar the codes are overall, and how much have the African countries mimicked their colonizers' examples. Also, and more importantly perhaps, do African codes have some characteristics that are contradictory to their colonizers and specific to their own environment? The codes are also evaluated both against their colonizers' codes but also with respect to how well the African countries' codes have been adopted to fit the emerging market environment compared to the developed market environment of their former colonizers. We shall also address, whether the countries religious or legal origin as well as mortality rate of the settlers are somehow visible in the investor rights protection and governance today.

For these reasons Africa is an important research subject, as we hope that with quality governance Africa could improve its reputation among investors, and through economic development improve the life of its population. Also for example former Unites States president Bill Clinton has recognized the investment potential of Nigeria, but declared that the government first needs to "put its house in order", if they want to reach their full investment potential (Okike, 2007).

1.2 Economy Characteristics

Many of the African countries have underdeveloped markets and financial institutions. However, there are some geographical differences in the development level, as some areas are more developed than others. For example, some countries, such as South Africa, Egypt and Nigeria are more developed and richer than the poorest countries, such as Congo, Liberia, and Eritrea (International Money Fund, 2014). Therefore, Africa as a whole cannot be characterised with one single market type. However, it cannot be denied that some of the poorest and most underdeveloped countries in the world are in Africa, and typically many of the countries have similar flaws and problems in their markets and community.

According to financial ratios, such as the liquid liabilities to GDP, countries is the Sub-Saharan region have significantly less developed markets compared to other emerging markets: in Sub-Saharan Africa the ratio was 29.7 % and for example in South Asia 55.1 % in 2007 (Allen, Carletti, Cull, Qian & Senbet, 2010). Therefore, Africa seems to be much behind other emerging markets in this regard, although some progress has been seen. However, the persistent view still is that much of the continent's markets have problems of corruption, and weak legal systems and regulation, and ineffective law enforcement (Munisi, Hermes & Randøy, 2014). Acemoglu et al. (2001) find that the reason for Africa's poverty, when compared to other markets, is not so much cultural or geographical, but is a result of worse institutions.

Therefore, relying on stock exchange regulation and focusing on issues that are only targeted at large companies is not the answer to the corporate governance problems in Africa on a larger scale. In free market systems, governments let markets themselves set prices through market supply and demand allocate resources most efficiently. However, governments intervene with markets if they do not work efficiently in these aspects, but governments may also intervene to promote their own agendas. One area that cannot be left unlooked in discussing African economy is corruption.

1.3 Corporate Governance Codes

The rules for corporate governance in different countries can be scattered in many different sources. Basic governance rules can be listed in statutory instruments, such as company laws, while more complex topics, such as takeover bids, can be referred in legislation or be promoted in listing requirements for stock exchanges. Companies can also have internal rules, for example, for board of directors that contain governance provisions, and informal traditions can also have an impact on governance. Corporate governance "codes" have been developed to coordinate these decentralized recommendations into consolidated governance codes. (Wymeersch, 2006). Thus, in markets, where the institutional setting might be failing to provide good-quality investor protection and rights, governance codes can be seen as a response to remedy these problems (Munisi et al., 2014). By complying with these codes, companies in such countries can signal investors that their governance equality is higher than the average country level would suggest otherwise. Here we shall describe the basic premise for corporate governance code development.

Governance policy systems can be divided into either hard law or soft law approaches (see for example Aguilera et al., 2008). Hard law systems refer to regulation, such as Sarbanes-Oxley Act, which regulates bindingly all of the companies that operate under its jurisdiction and defines the minimum standards for governance. However, the soft law approach is usually based on the comply-or-explain model.

However, although the comply-or-explain model should in theory ultimately lead to better governance by giving companies more discretion and flexibility over their own governance to make suit their environment, it seems to work better in fostering command compliance rather than in explaining noncompliance (Arcot et al., 2010). Arcot et al. suggest that the major problem with the approach is that the explanations for non-compliance are not sufficient, and companies frequently use standard explanations rather than profound and true reasons for not complying with the codes. Also MacNeil and Li (2006) point out that investors are tolerating the non-compliance and vague explanations from the company, if the financial performance of the firm is sufficient. Therefore, it could be assumed that shareholder pressure is mainly targeted on compliance only, rather than explaining reasons for different practices. This could mean that shareholders do not truly understand and value the benefits of tailored and firm specific governance practices as much as they should. This is rather prejudiced, as high quality explanations for not complying with the corporate governance code are connected to higher corporate performance (Arcot & Bruno, 2006).

In addition to this, MacNeil and Li (2006) have criticized the comply-or-explain model for offering the shareholders a weaker role than the board of directors in governing the company, as they only get to review compliance ex post as opposed to the board. This appears ironic as the target of the codes is to reduce principal-agent problems. They argue that the comply-or-explain model does not really offer any better results than what could be achieved with default rules in company laws. Thus, although comply-or-explain model seems to be the prevalent and most distinguished approach on which to base corporate governance codes, it is not without its problems.

Market and Institutional Based Systems

The most common way to classify different corporate governance systems is to divide them between the market-based system (Anglo-Saxon) and the institutionally-based system (German) (Prowse, 1994). However, many of the governance systems around the world do not fit into either one of these perfectly, as there are many hybrid systems, and some of them have their own specific details. For example, Weimer and Pape (1999) have classified four different governance systems around the world, which are Anglo-Saxon, Germanic, and Latin countries, and Japan.

The market based system, or the Anglo-Saxon model, is characterized by widely dispersed ownership, one-tier boards, less close relationships between shareholders and managers, and greater demand for market for corporate control (Rwegasira, 2000). In these markets, the principal-agent conflicts may arise and therefore much of the mechanisms are directed at aligning the interests of managers and shareholders. On the other hand, institutionally-based Germanic system suggests a close relation between large shareholders and managers as well as between managers and employees, recommends a two-tier board system which clearly separates management of the company and supervision, and is characterized by banks having high stakeholder influence (Weimer & Pape, 1999). Today most of German companies for example may be nominally owned by many shareholders but in reality are controlled by large banks via proxies (Morck & Steier, 2005). Generally, there is a weak market for corporate control, as large shareholders can control and monitor management through boards and other mechanisms by themselves. Also the two-tier board system, which is a major characteristic of German corporate governance, was developed and written into German Company Law already in 1870 (Morck & Steier). Performance based compensation policies have traditionally been more limited in Germanic countries than in Anglo-Saxon countries (Weimer & Pape, 1999), although there has been a rise in the performance based compensations also in Germanic countries.

It has been found that optimal governance differs between emerging and developed markets (Bebchuk & Hamdani, 2009), and even between emerging markets (Durnev & Fauver, 2007). Based on the corporate governance bundle idea, the context of the country and the specific context of an individual company determines what corporate governance mechanisms should be most suitable for that given environment and that company. Thus, no one universal law can be used to determine the best governance code.

1.4 Legal Protection of Investors

Many times corporate governance research has been done from the financing perspective, comparing bank financed systems, such as German system, to market-based systems, such as that of United States (see for example Allen & Gale, 2000). However, this point of view does not work as well when trying to compare systems that are a combination of the two, as many countries at the moment are. This notion has generated different perspectives for looking into governance systems, and one of the most famous perspectives is the legal protection of investors in different markets. This means the protection of rights of both creditors and shareholders from expropriation conducted by both management and large shareholders. Expropriation can happen in a variety of ways: selling and buying assets to their own companies above or below market prices, overpaying management, targeted dividends, or even simply stealing the profits of the company. The legal protection refers both to the laws that are in place and to their enforcement in the country. (La Porta et al., 2000)

The extent of legal protection of investors varies greatly around the world, as in for example United States, Japan and in Western Europe the law protects the rights of investors relatively well, and courts are willing and able to enforce these laws. However, in most of the less developed markets, the legal system is too weak to offer true legal protection of investors (Shleifer & Vishny, 1997). This then affects also the governance level of companies in such countries, as for example Klapper and Love's (2004) find that the quality of governance is lower in countries with weak legal protection. However, good corporate governance through for example soft law codes could improve the protection of investors' rights even if the legal environment in general would not provide much protection.

Mechanisms for Protection

As Bebchuk and Hamdani (2009) suggest, the classification between controlling shareholders and diffused ownership can be used to develop governance methodologies for different companies. Here we shall discuss the possible violations of investor protection in both cases but mainly focusing on the concentrated ownership companies, as they are more relevant in the case of Africa. Shleifer and Vishny (1997) state that shareholder voting rights are violated more boldly in countries with low legal protection than elsewhere. For instance, management can neglect to inform shareholders about annual meetings, and prevent shareholders with dissenting views from voting based on technicalities. In these situations, governance codes should address especially the ways in which minority shareholders can protect themselves against the expropriation of large shareholders. For example, superior voting rights and significant departures from the one-share-one-vote practice can enable large owners to abuse their power over other shareholders (Shleifer & Vishny). Through this kind of means, owners can for example use their power to pay themselves extra dividends or issue targeted share repurchases to benefit themselves. Also controlling shareholder can only elect those directors that run their own causes rather than those of all shareholders. As in Africa ownership concentration is common, the appropriation of large owners could be a significant problem, and therefore they should focus their corporate governance recommendations to address this issue.

Escaping Weak Legal Environment

La Porta et al. (1998) argue that the extent of investor rights' protection and the extent to which those laws are enforced, are the major determinants for corporate governance evolvement and development in a specific country. If the investor protection is therefore so important determinant for governance, what can companies do in countries with weak legal protection? First of all as the markets become more open, the importance of country characteristics, such as investor protection and legal enforcement, are reduced by financial globalisation (Doidge et al., 2007). Doidge et al. argue that if firms can access foreign capital markets, then they are less dependent upon national economic development and can shield themselves partly from weak national protection. Companies can avoid some of the disadvantages of their own country's governance if list their shares in foreign stock exchanges, and investors can file claims better on international courts if for example investor rights have been violated. Famous foreign stock exchanges have higher requirements for firm's governance, such as transparency and disclosure standards, than many national codes would require (especially in emerging markets) and thus companies can borrow the governance of more developed markets by listing in them.

Origin of Legal Protection

Why does investor protection then differ between countries? La Porta et al. (1998) state that the legal origin of a country explains partly the degree of investor protection, and common law countries have better investor right protection than civil law countries. Therefore, countries with Anglo-Saxon traditions or English colonies should have better investor rights, and thus also the former British colonies in Africa should have higher investor protection than for example French or German countries. However, the importance of country's legal origin in this issue is not entirely agreed upon. Stulz and Williamson (2003) argue that culture should not be ignored in this discussion. They argue that country's dominant religion predicts investor right's better than for example language, or even better than country's openness to international trade and the origin of its legal system. Also Bebchuk and Roe (1999) remind that corporate rules and regulations that will be chosen and persist over time in any country are dependent on the strength of relevant interest groups. Thus, although for example the religious base of a country might have changed over time, the same rules can persist anyhow, if there are strong enough authorities who are able to impede any changes on regulation that this kind of change could have caused in other markets.

1.5 Efficient Governance Practices

Africa has had much less attention in many research areas, including corporate governance. In this section we will present relevant research that has been done about the corporate governance particularly in Africa. Much of the research suggests that African countries have promoted corporate governance practices similar to those prevalent in developed countries (see for example Munisi et al., 2014), of which one example is the introduction of corporate governance codes.

The general view is that different corporate governance mechanism can be used as a substitute for each other (Munisi et al., 2014). Ownership concentration should theoretically be an efficient governance mechanism in many places in Africa, where the access to global financial markets is difficult (Shleifer & Vishny, 1997), as large shareholders can monitor the management better than many scattered small shareholders could. However, Tsegba and Ezi-Herbert (2011) have found that ownership structures such as concentrated ownership or dominant shareholders do not have significant effect on firm performance in Nigeria, and therefore their use as corporate governance mechanisms to improve performance should be reconsidered. This ineffectiveness may be partly due to crony capitalism, and to large block holders who can extract rents the same way as managers might (Ayogu, 2001). Therefore, it is still possible that concentrated ownership and its mechanisms, when applied in markets with less corruption and with better minority shareholder protection, could be the answer to what governance practices should be adopted. However, the findings of Tsegba and Ezi-Herbert show that the effectiveness of concentrated ownership as a governance mechanism on performance is debatable, especially in corrupt markets.

If we take the view that in markets where external governance mechanisms and external financial markets are undeveloped companies should rely more on internal governance mechanisms, then particularly the board of directors and its characteristics become important governance mechanisms (Munisi et al., 2014). Generally larger boards are considered to be less effective in decision making, and increasing board size has been found to be negatively correlated with firm performance (Hermalin & Weisbach, 2001). Nonetheless, there have also been findings that would suggest that actually larger boards would enhance corporate performance and shareholder value in Ghana, Kenya, Nigeria and South Africa (Kyereboah-Coleman, 2007), and therefore at least in African context larger boards could actually be effective.

1.6 African Governance Codes

A specific characteristic that differs from Western cultures is the African value system called Ubuntu, which signifies a broad understanding of coexistence, consensus, and consultation (Rossouw, 2005). Mangaliso (2001) describes

Ubuntu as humanness, spirit of caring and community, and as responsiveness. As the basis for the value system of the culture is broader than it might be in some European countries traditionally, making only the interests of shareholders and accountability to them the objective of corporate governance should be impossible in Africa. Although still, it is possible that countries have followed, so to speak, too closely the example of their colonizers in understanding of whose interests' matter. However, at the moment as there is a constantly growing interest on corporate responsibility and accountability in developed markets too, we should not take for granted the general views on what and who matter in business in each market.

There is still a shortage of collective corporate governance code analysis on African countries. One of the few studies that refer to corporate governance codes or recommendations in Africa collectively is by G.J. Rossouw, whose research in 2005 examined different governance reports and codes of eleven African countries. Rossouw (2005) identifies general patterns in the institutionalization of corporate governance and describes how relationship between corporate governance and business ethics is understood. The role and responsibility of board is a major similarity in many of the African corporate governance recommendations.

One good example of a less successful development of corporate governance practices is from Nigeria, which has been described by Okike (2007). Mimicking the United Kingdom's Company's Act in Nigeria initially lead to the overlooking of Nigeria's peculiar social and political environment. While becoming independent Nigeria, like many other colonies, inherited many rules and regulations from their former colonizer Great Britain. During the colonial period Nigeria was introduced with the British company law and thus Nigeria's laws as well as corporate governance practices reflected the British system and practices.

After gaining independence, Nigeria had to replace their old British company law by their own in 1968. However, this law also mirrored the British Company Act of 1948 very closely, as many British people still controlled much of the business activities in the country. Therefore, in the case of Nigeria the development of governance was highly exogenous. However, the corporate governance instructions of this act did not suit the environment of Nigeria, with tribal conflicts, corruption and rapid economic development. Although Great Britain has had its own corruption problems, they are mostly intangible and involve mainly marginal groups, and therefore the Company Act of United Kingdom do not address these issues enough to be appropriate and effective for Nigerian environment. Even strong governance codes and recommendations are not effective when supportive macro-economic and political and social institutions are not in place (Ahunwan, 2002), and therefore the recommendations of UK did not suit Nigeria.

Many of the studies related to corporate governance are focusing on the relationship between corporate governance and their effect on performance. However, Akinkoye and Olansamni (2014) have tried to inspect the level of compliance in Nigeria on their 2003 issued code of best practices in corporate governance.

1.7 Accounting and Corruption

Although major corporate governance literature is concerned about agency theory and reducing management expropriation, states, governments and public officials can also expropriate funds from companies through means of corruption. Transparency International (2004) has defined corruption as the abuse of entrusted power for private gain, and therefore we cannot limit the term only to concern public affairs. Corruption can be divided into public corruption (paying bribes to obtain goods that are monopolized by the government) and private-to-private corruption. Even in countries with relatively low levels of corruption, local corruption can feed the overall culture of corruption, which can in turn reinforce private and public corruption in the nation level (Dass, Nanda and Xiao, 2014). Therefore, the overall environment of the market can affect companies negatively, even though the companies would not submit to corruption themselves.

Most of the researchers agree that corruption is a burden to the economy as it distorts decision making and can lead to suboptimal allocation of resources, as less productive or efficient practices get resources while more efficient alternatives will not (Shleifer & Vishny, 1993). The negative effects of corruption can easily multiply: it causes cynicism as people start to regard corruption as the norm of doing business and weakens social values as people find corruption as an easier path than legitimate transactions (Lawal, 2007). Besides the misallocation of resources, the secrecy of bribery also makes it costlier to the economy than tax payments, which can be viewed as a sister-concept for corruption (Shleifer & Vishny, 1993).

1.7.1 Governance in Corrupt Environments

There is not clear evidence on how accounting procedures, such as corporate governance, affect processes of corruption. It is evident that accountants often have a good possibility to observe and discover wrongdoings in organizations because of their close connection to organizations' control and auditing processes (Kimbro, 2011). Ideally therefore their role should be to prevent and discourage financial frauds and malpractices. However, Neu, Everett, Rahaman and Martinez (2013) suggest that accounting at the same time can limit but also enable and facilitate corruption, as a" skillful" use of accounting methods and social interactions together can enable corruption even in developed markets.

Therefore, one of the major problems for corporate governance in relation to corruption is, whether companies in more corrupt countries can overcome the problems caused by corruption with stronger governance. This question has not had a unanimous answer among researchers. If companies operate in an environment where bribes are expected of them to achieve or attract business and corruption would affect all companies (i.e. companies are victims), then investments in better governance would be unnecessary. However, if the companies themselves feed and participate in the culture of corruption by rent-seeking, earnings management etc. then stronger governance mechanisms become more important as companies can improve their image and signal their better quality to investors through governance and overcome some of the harmful effects of corruption (Dass et al. 2014). Stronger internal governance thus assures that the control as well as cash flow rights of investors are protected, even if the external governance would be weak.

1.7.2 Corruption

One of the major questions for corporate governance in relation to corruption is, whether companies in more corrupt countries can overcome the problems caused by corruption with stronger governance. Dass et al. (2014) argue that higher quality corporate governance would be especially important and valuable to companies which operate in areas with higher local corruption, and could help companies to overcome at least partly the corruption problems caused by weak institutions. However, for example Durnev and Fauver (2007) argue that the positive effect of higher quality governance is weaker or even non-existent in more predatory states where corruption is evident. An expected result is that countries with highest corruption levels do not have a corporate governance guideline at all in place at the moment in Africa. Our study findings, which show that both the mean and median of those African countries which have a corporate governance code are higher than of those African countries which do not currently have a code, thus support the argument that problems of corruption can be fought with stronger corporate governance. Also, as the mean and medians are approximately the same inside each group of countries, the statistics are not significantly skewed to either end of the index, therefore making this suggestion more plausible.

2.2 Theoretical Frame Work

The survey study of Shleifer and Vishny's (1997) approach corporate governance from the agency theory perspective. Agency theory certainly has been the major theory and basis for empirical literature to understand corporate governance (Aguilera, Filatotchev, Gospel & Jackson 2008). Therefore, much of the corporate governance literature and recommendations have focused on alleviating the possible principal-agent problems. Agency theory refers to the agency relationship between the principal, who delegates their work and power to the agent, who then performs the work on behalf of the principal (Eisenhardt, 1989). However, conflicts may arise when the desired goals of the principal and the agent are in conflict, and if the principal cannot check and make sure that the agent is working really in the interests of the principal. Agents can choose to hide information from the principals, expropriate funds or make decisions that only benefit themselves at the expense of the principal (Lubatkin, Lane, Collin & Very, 2007). Therefore, principals want to invest in monitoring and alignment of agents' interests with their own with incentives, to protect themselves against the opportunistic behavior of the management (Lubatkin et al, 2007).

The agency theory is concerned about the principal-agent conflicts which may arise when there is enough of diffused ownership, and owners do not then have enough control over management directly. However, in markets with concentrated ownership the traditional agency problems may not be as severe, but instead principal-principal conflicts may arise as different owners have different interests and different levels of control and power over the company. This approach has become known as the principal-principal model of corporate governance (Young, Peng, Ahlstrom, Bruton & Jiang, 2008). Therefore, as we are focusing on a market where concentrated ownership is common, we shall take into account this principal-principal perspective when describing the problems and recommendations of African corporate governance.

2.3 Methodology

This study applied the use of archival research techniques in gathering information from different countries' policies and recommendations on corporate governance. Archival research refers to conducting a study using data that the researcher has not collected themselves, but the researcher selects the data to be analyzed from already available and existing data (Mc Burney & White, 2009 p. 228). The data that is already available is suitable for the objectives of this study, as the aim is not to find out if the companies are actually following the guidelines in practice, but to compare the already existing governance codes against each other.

As one of the advantages of the archival research is the possibility to revisit data multiple of times, we have been able to include issues that were initially thought to be self-evident or not as important for this research, but which appeared to be recommended differently in many codes, and thus, were finally included in this study.

2.4 Conclusions

The objective of this study has been to address whether corporate governance codes in Africa are adequate for African environment, and have the codes been adapted to fit their environment. Although the continent is not similar in every aspect, African context can in general be described with high amount of informal businesses, concentrated ownership, problems with weak legal institutions and high levels of corruption. All these issues have an effect on what kind of corporate governance mechanisms can be useful and effective. Therefore, following too closely the recommendations and guidelines of country's former colonizer might not be effective, as their codes are developed to fit their own context with more developed financial markets and stronger institutions.

Major finding for this research has been that African countries have rather followed the route of Anglo-Saxon corporate governance as opposed to the Germanic governance recommendations, even though the countries would have had both Germany and Great Britain as its colonizer. This can be especially seen with the unitary board recommendations over the dual board system. However, there is variation in the level of how much countries have mirrored especially other colonizers' codes as well, and the major similarities between colonizers with shareholder right recommendations in general. Also the performance related remuneration is a major similarity between the colonies and colonizers, although it might not be as effective mechanism in Africa as it can be in other markets. It seems that the corporate governance framework in Africa in relation to European colonizers is twofold: on one other hand African countries seem to be leading Europeans and encourage wider stakeholder inclusion, but on the other hand some countries seem to be lagging in especially independence guidelines.

Corruption is still a major issue for many a country in Africa, which makes the commitment to more ethical business behind the scenes harder. Corruption level of the country can be seen in some of the codes, as some highly corrupt countries do address problems of corruption more profoundly than other countries. This can also be seen in the updates of previous codes, as for example Nigeria has taken into account specific problems and criticism directed at their previous code and improved their revised code to better fit with their context. Also, the colonizers' mortality rates are lower in those African countries which have issued a corporate governance code, implying that the institutional development has been higher in these countries, which has resulted in better developed corporate governance as well. Therefore, the researcher emphasizes the importance of colonial heritage in the development of corporate governance codes in Africa. However, our results show that countries have not merely mirrored their colonizers' codes directly, but rather the importance of the colonial heritage is more indirect through institutional development and colonization strategy.

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