

SECURITIES AND EXCHANGE COMMISSION



Corporate Governance and Stock Market Development

Seminar Presentation
Bayero University Kano

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1. It is a great delight to be here in this hallowed academic environment to speak on a topic that is very close to my heart, which is also a very topical issue in Nigeria today. I thank the Distinguished Professor for the kind invitation to speak to a group of intellectuals. It is heartwarming to note that I was nurtured and trained in this same great institution of higher learning and I am happy that the standards are still being maintained. Bayero University Kano must continue to be a shining example of a great intellectual environment encourages continuous exchange of ideas.
2. I have been asked to speak on “Corporate Governance and Stock Market Development” and I must commend you for this wonderful choice of topic because corporate governance and capital markets are so closely inter-related. They essentially reinforce each other. On the one hand, stock markets directly contribute to the enhancement of corporate governance because of their robust listing, disclosure, transparency, monitoring and compliance standards. On the other hand, corporate governance improves the integrity of the stock market and attracts investors.
3. As I would be covering within this paper, the Securities and Exchange Commission (SEC), being apex regulator of Nigeria's capital market, is charged with regulating and developing the market. Corporate governance has emerged as a veritable tool for enabling us achieve this dual mandates. It is so central to our mandate both as an investor protection instrument and also as a means to institutionalize best practice across the market.
4. I will begin my presentation by advancing some definitions of corporate governance after which we shall trace the evolution of corporate governance over time and across jurisdictions. We shall equally be considering the corporate governance landscape in Nigeria with more focus on the role of the SEC in deepening compliance to corporate governance. We will thereafter conclude the presentation by underlining the symbiotic nexus between corporate governance and market development.

What is Corporate Governance?

5. According to the online investment dictionary – Investopedia¹ – corporate governance is the system of rules, practices and processes by which a company is directed and controlled. It strives to balance the interests of the various stakeholders in a company such as shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.
6. Corporate governance is also a framework understanding the performance of a business. The Business Dictionary² sees the corporate governance framework as consisting of explicit and implicit contracts between a company and its stakeholders for distribution of responsibilities, rights, and rewards. It specifies procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges, and roles, as well as procedures for proper supervision, control, and information flow to serve as a system of checks and balances.
7. From the above definitions it is apparent that corporate governance involves: shareholders, management, board of directors and other key stakeholders - Shareholders provide corporations with capital and are meant to supervise efforts of the board; Management utilizes that capital provided by shareholders while the Board of directors supervises management to ensure that it is using the resources efficiently. Expectedly the interests of these divergent groups are sometimes difficult to align, and this is where a framework comes in to define roles and responsibilities.
8. To buttress the importance of good corporate governance, let me share with you two quotes, one from Sir Adrian Cadbury, who is widely considered as

¹ <http://www.investopedia.com/terms/c/corporategovernance.asp>

² <http://www.businessdictionary.com/definition/corporate-governance.html>

the father of modern corporate governance codes. He said, *“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interests of individuals, corporations and society³”*. The other quote is from Mervyn King who chaired the famous King Report that gave rise to South Africa's corporate governance code. He said *“Good corporate governance is about 'intellectual honesty' and not just sticking to rules and regulations⁴”*.

Evolution of Corporate Governance

9. Corporate governance in its present form began in England in the early twentieth century, when a separation emerged between ownership and control of businesses. This separation of ownership from control made perfect economic sense as businesses could tap the market for capital and executive talent separately. However, this separation presented an agency problem, necessitating the emergence of modern corporate governance - a system to ensure accountability by those who run companies to those who invest in these companies.
10. Policymakers and regulators alike recognized the need for a body of rules and practices that will reconcile the interests of various stakeholder groups. Since regulation is one proven way to provoke behavioural change, governments, policymakers and regulators around the world have devoted significant time and resources to the development of legislation and policies related to corporate governance.
11. One of the earliest bodies of corporate governance principles was the 1992, UK, Cadbury Report. The principles became imperative in the wake of major corporate governance scandals, particularly the collapse of Polly Peck, (a major UK company back then) after several years of falsifying its financials.

³ Sir Adrian Cadbury, UK, Commission Report: Corporate Governance 1992

⁴ King, 1994

The Cadbury Report was subsequently expanded and upgraded to a non-mandatory Code in 2010. In the United States, following from the collapse of Enron and WorldCom, there was an enactment of mandatory Sarbanes-Oxley Act in 2002.

12. South Africa on the other hand, has a Corporate Governance Code which is not legislative, but rather a set of practices and principles which were issued in three different Reports, King I in 1994, King II in 2002 and King III in 2009. The distinguishing feature of the King Report was that the first Report in 1994 went beyond the financial and regulatory aspects of corporate governance and advocated a holistic approach of including principles of good social, ethical and environmental practice⁵.
13. In the US, following the collapse of Enron and WorldCom (now MCI), there was an enactment of the mandatory Sarbanes-Oxley Act, in 2002. The Act is intended to ensure the reliability of publicly reported financial information and bolster confidence in US capital markets. It contains extensive provisions on duties and penalties for corporate boards, executives, directors, auditors, attorneys, and securities analysts.
14. The Organization for Economic Cooperation and Development (OECD) responding to the Asian crisis, issued on June 21, 1999, a set of corporate governance principles to help governments around the world to make an assessment of the existing legal, institutional, and regulatory framework for corporate governance in their respective countries and use the OECD principles to strengthen them where necessary. The OECD Principles are deliberately focused on broad corporate governance features rather than detailed prescriptions. This approach to an international benchmark has clear advantages in a field where implementation needs to be adapted to varying legal, economic and social conditions.
15. These Principles were revised in 2004 to provide for a stronger role for shareholders, greater emphasis on preventing conflicts of interest and self

⁵ South African Institute of Directors (<http://www.iodsa.co.za/?kingIII>)

dealing, controlling abuse of related companies, ensuring the basis for an effective corporate governance framework and promoting transparency and effective enforcement. These are all key areas that are important to a market conduct regulator like the SEC.

16. In dealing with conflicts of interest, the Principles now advocate not only disclosure, but also statements by the parties involved as to how the conflict is being managed. The special conflicts between controlling shareholders and minority shareholders were also explicitly addressed⁶. The provisions include a new principle which recognizes the role of various providers of corporate information, such as rating agencies and analysts, whose advice should not be compromised by conflicts of interest.
17. And we all witnessed in fully display during the global financial crisis when rating agencies escaped culpability in spite of their role in fueling the crisis. This is why the global body for securities regulators that we belong to as SEC – the International Organization of Securities Commissions (IOSCO) – issued new principles⁷ that define very specific regulations for rating agencies and auditors in this respect. The duties of the auditor have been strengthened, and include accountability to shareholders and a duty to the company to exercise due professional care in the conduct of the audit.
18. With regard to ensuring the basis for an effective corporate governance framework which was largely implicit in the 1999 Principles, a new chapter was introduced to deal with the regulatory system which is seen as a major barrier to fostering improved corporate governance in many countries. This new chapter sets out broad principles for governments to follow when they review the corporate governance framework which is necessary for them to achieve the objectives or outcomes advocated by the Principles.
19. Some of the guidelines provided are that, the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law, and clearly articulate the division of responsibilities

⁶ Amendment to King III

⁷ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>

among different supervisory, regulatory and enforcement authorities. Such framework should be developed with regard to its impact on the overall economic performance, market integrity and the incentives it creates for market participants for the promotion of transparent and efficient markets. Also the legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

20. Also the review touched on some specific stakeholder issues, especially important is a new principle to ensure protection for whistleblowers, including institutions through which their complaints and allegations might normally be registered. The role of employees as a stakeholder is also complemented by new principles calling for an ethical code to be established by the board, and for effective rewards and penalties to be established in order to ensure compliance with relevant laws and standards. These principles therefore serve to establish a clear role for employees in the corporate governance process.
21. The guidelines have caught on as a benchmark for good practice in corporate governance. The Financial Stability Forum⁸ (FSR) has adopted these principles as one of its key instruments for ensuring international financial stability while the World Bank⁹ has adopted them as a benchmark for supporting the development of sound corporate governance in emerging markets.
22. International organizations such as the Basel Committee, IOSCO, and the International Association of Insurance Supervisors (IAIS) have also drawn from the collective supervisory experience of their members and other authorities in issuing supervisory guidance for sound policies related to corporate governance.
23. Several other jurisdictions have revised their rules to identify gate keepers to include Auditors, Lawyers, Research Analysts, Broker Dealers, Board of

⁸ http://www.financialstabilityboard.org/2010/10/cos_101004/

⁹ http://www.worldbank.org/ifa/rosc_cg.html

Directors, and by so doing, raising the responsibility required of each stakeholder group in their corporate and individual capacities.

24. Corporate governance and corporate social responsibility indices are becoming a basic barometer for benchmarking corporate governance practices and for evaluating compliance levels. In 2013, the World Bank/IFC conducted a study of corporate governance indices and I am very happy that the study revealed that emerging markets have led the way in efforts to raise the standard of corporate governance.
25. Among the eight stock exchanges (Brazil, China, Italy, Mexico, Peru, South Africa, South Korea, Turkey) in the world with Corporate Governance indices (CGIs), seven are emerging markets. Let me note here that the Nigerian Stock Exchange has launched its own called "The Premium Board" which groups some of the best governed listed companies. The World Bank study¹⁰ also revealed that CGIs can raise a country's overall corporate governance standards since they offer companies financial and investment incentives to make governance improvements. In 2007 the Chinese Securities Regulatory Commission led an initiative to improve corporate governance of listed companies which led to the launch of the Shanghai Stock Exchange (SSE) CGI starting with 199 companies. That index is very stringent because you have 953 companies listed on the Shanghai Stock Exchange, but only 266 companies are admitted to the index, as at today.
26. Another important global initiative is the Sustainable Stock Exchanges initiative (SSE), developed by the United Nations as an initiative aimed at exploring how exchanges can work together with investors, regulators, and companies to enhance corporate transparency, and ultimately performance, on environmental, social and corporate governance issues and encourage responsible long-term approaches to investment. It was named by Forbes magazine as one of the "World's Best Sustainability Ideas". Eight exchanges with nearly 13,000 listed companies in developed and

¹⁰ World Bank/IFC, Raising the Bar on Corporate Governance: A Study of Eight Stock Exchange Indices, June 2013

emerging markets have already joined this initiative since its creation in 2009, including NYSE Euronext, NASDAQ OMX, BSE Ltd., BM&FBOVESPA, the Johannesburg Stock Exchange (JSE), the Egyptian Exchange (EGX), and MCX Stock Exchange Ltd. (MCX-SX). I am very delighted that our own Exchange following prodding by the SEC has also joined the global initiative¹¹.

27. What I have attempted to do so far is review with you what corporate governance means, where it started, but most importantly, the breadth in terms of how corporate governance is perceived today. Now that I have given this broad overview as to where we are today, let us talk about our experience in Nigeria.

The Corporate Governance Landscape in Nigeria

28. Nigeria is running with the rest of the world in institutionalizing sound corporate governance and best practices. Many basic shareholder rights are already protected by law and in addition, the Securities and Exchange Commission (SEC) has also issued guidelines to regulate shareholder associations. All key financial sector regulators have issued codes to regulate conduct of participants in their respective industry and to prevent any form of regulatory arbitrage on the part of the regulated institutions.
29. In the 90's, the effect of weak corporate governance were evident manifesting in overvaluation and concealment of level of indebtedness by some companies and the collapse of some banks. In recognition of the losses suffered by investors, the SEC in 2003, in collaboration with the Corporate Affairs Commission (CAC) launched the first ever code of corporate governance for public companies in Nigeria. With the emergence of the global financial crisis and the lessons learnt, the Commission once again set up a Committee headed by Mr. A. B. Mahmoud to review the 2003 Code to address its weaknesses and to recommend ways of effecting

¹¹ www.Sustainability-reports.com

greater compliance in accordance with internationally acceptable practice. This was particularly important as several systemically important financial institutions were on the verge of collapse, largely due to weak corporate governance and risk management structures. The Central Bank had to intervene in these Banks to prevent a systemic collapse.

30. Also to further strengthen corporate governance policies and practices of listed companies in Nigeria, the Government of Nigeria invited the IFC/World Bank to conduct a corporate governance policy assessment (CG ROSC) in 2008. The Corporate Governance ROSC assessment of Nigeria benchmarked law and practice against the OECD Principles of Corporate Governance, focusing on the companies listed on the Nigerian Stock Exchange. A survey of disclosure practices, suggested a relatively high compliance with many good-practice principles.
31. Since the ROSC review, and as an outcome of the work of the Committee led by Mr. A. B. Mahmoud, the SEC launched a new Code of Corporate Governance, in 2011. The 2011 Code for public companies, addressed gaps identified in the 2003 Code and the ROSC report. Some of the relevant areas that were addressed in the 2011 Code include performance evaluation of boards, requirement for the establishment of an audit committee for each board, whistle blowing, risk management and the appointment of at least one independent director to the board of a public company.
32. The Central Bank of Nigeria (CBN) in the same vein introduced the CBN Code of Corporate Governance for Banks in 2003 (amended in 2006¹²) to guard against the re-occurrence of corporate governance failure in banks as witnessed during the period leading to the financial crisis. The crisis threw up the urgent need to have independence on boards of financial institutions, especially banks, prompting the CBN in October of 2007, to release a

¹² <http://www.cenbank.org/out/PUBLICATIONS/BS/2006/CORPGOV-POSTCONSO.PDF>

circular¹³, outlining its position, on the definition and roles and responsibilities of independent directors of banks.

33. In 2008, the National Pension Commission (PenCom) published a mandatory Code for licensed pension fund administrators. In 2009, the National Insurance Commission (NAICOM) introduced a corporate governance Code for insurance companies.
34. As you may have noticed, the only Code which cuts across all these industries is the SEC Code since it applies to all listed companies regardless of their industry of operation.

SEC is Strengthening Compliance to Corporate Governance

35. As part of strengthening compliance with the Code, the SEC has used the 2011 Code to produce a Corporate Governance Scorecard which aims to make certain aspects of the Code (backed by CAMA) mandatory. This will improve the quality of corporate governance reporting, incentivize the right behaviour and promote competition among public companies. The Scorecard, which we developed with support from the IFC, will hopefully be launched next week on 26th November 2015. It combines a robust and comprehensive corporate governance reporting checklist that enables benchmarking corporate governance practices amongst public companies.
36. Companies will be required to provide information on compliance using a standardized template. This information will be scrutinized and verified through on site reviews and off site inspections. The verified information will then be integrated into a score card which will provide a snapshot of how companies rank in their corporate governance practices. This will ultimately ensure more rigorous self-analysis of company corporate governance; forcing better governance disclosure that will allow the markets to pressure companies; and forcing boards to be more accountable by making them certify their corporate governance disclosure.

¹³ BSD/DIR/GEN/CIR/VOL.1/013

37. Also the Commission is spearheaded the adoption of International Financial Reporting Standard (IFRS) amongst listed companies. The SEC has partnered with the World Bank to provide training for SEC staff in this regard. Subsequently, IFRS clinics were organized for companies which are experiencing teething problems and challenges in implementing this process. Once this accounting and reporting standard is fully adopted and implemented across all sectors, it will enhance the corporate governance profile and practice of companies in Nigeria by improving transparency in financial reporting and the quality of financial statements. It will also enhance global comparability of financial statements as well as timeliness of financial reporting.
38. The SEC hopes that with these initiatives and the making of the Code mandatory, the corporate governance practices in firms will become world standard. We are very committed to providing the regulatory and monitoring tools to check corporate governance practices of public companies, because as a policymaker, enforcer and overseer, the SEC recognizes that sound corporate governance structures are particularly important for emerging markets like Nigeria that want to join the club of the most important economies in the world.

The Dividends of Good Corporate Governance – The Nigerian Story

39. In my opinion, progress has been made on the key issues of effective corporate governance in Nigeria, but a lot still needs to be done. Part of the dividends from the overall governance reforms include the removal of Nigeria from the Financial Action Task Force (FATF) list of non-cooperating countries with respect to combating money laundering, the acceptance of Nigeria's Financial Intelligence Unit (NFIU) into the Egmont Group of Financial Intelligence Units to share intelligence, training and expertise and the removal of Nigeria from the international credit blacklists. These would not

have been possible without the on- going corporate governance reforms across the financial sector of the economy.

40. In spite of all the progress we have made, we need to do more to advance our competitiveness by institutionalizing sound corporate governance practices. The World Economic Forum in its 2015 Global Competitiveness Index, ranked Nigeria 132nd out of 148 countries assessed, while Brazil and South Africa ranked 107th and 32nd respectively. On specific indicators related to corporate governance, Nigeria ranked 132nd in ethical behavior of firms, 106th strength of auditing and reporting standards, 108th board efficacy, 101st protection of minority shareholders and 57th investor protection. South Africa does better than Nigeria in the overall ranking due largely to its perceived strong corporate governance track record as it ranks highest in the world in three of the corporate governance sub-indices. We must push even further and collectively sustain our efforts towards achieving best corporate governance practice.
41. Regulators must continue to play a leading role in ensuring that firms have the right governance culture in place. But I should stress that it is not for the regulator to determine the culture. Ultimately, even a successful regulatory regime will not be sufficient to ensure good outcomes. Crucially, firms need to have an appropriate culture and one which is focused on the firm delivering the right long-term obligations to stakeholders. The right cultures are rooted in strong ethical frameworks.
42. Nevertheless, history tells us that we cannot rely on the motivation of individuals alone and that we need credible enforcement to require individuals to be driven by principles rather than just commercial expediency. As Voltaire, the famous French philosopher and historian argued *“It is well to kill from time to time an Admiral, to encourage the others”*. Voltaire's words are shocking if taken literally, but in essence it is a way of saying that rules must be given teeth through enforcement actions. I say *“it is okay to punish, penalize and impose fines from time to time”* and we at the SEC have shown

clearly that we will not hesitate to do that when necessary. Enforcement actions level the playing field, send a message to the broader public and deter would-be violators.

43. In this regard we have strengthened our enforcement machineries and revamped our Administrative Proceedings Committee (APC). This is to ensure that we fulfil our mandate of protecting the ordinary investor by providing a neutral platform for hearing investor complaints, especially the ones that affect ordinary investors and threaten the integrity of the market. We have gone to great efforts to protect the integrity of this process by ensuring fair hearing for all parties, the independence of the Committee, speedy disposal of matters and to bringing scope and diversity to the deliberations. Through this reconstituted Committee, we plan to send a message to the market that the SEC will not tolerate wrong doing and will be firm and resolute in bringing erring parties to book.
44. Whistle blowing is another area we intend to emphasize to improve compliance. Section 306 of the Investment and Securities Act (ISA) 2007, and Section 32 of the 2011 SEC Corporate Governance Code, provide adequate guidance on whistle blowing mechanisms and the required protection for persons who disclose information connected with the activities of their employer. And if you have ever been the subject of an SEC investigation, you can attest to how important we feel this whistle-blowing mechanism is. The whistle blower provision is enshrined in the law to strengthen disclosure and to encourage stakeholders to disclose information necessary for the regulator to intervene in a timely manner and to protect the whistle blower from the reprisal of his employer. A former CEO of the Financial Services Board of South Africa, Rob Barrow, said it in a manner that I think is very apt. He said *“the earlier the regulator’s office becomes aware that a particular entity is not complying with regulatory requirements, the more likely it will be that corrective action can be taken to avoid significant loss to investors¹⁴.”*

¹⁴ Rob Barrow: Financial Services Board

Nexus Between Corporate Governance and Performance

45. The integrity of businesses is central to the vitality and stability of our economy. Businesses should, therefore, at all times foster a corporate governance framework that promotes market integrity, the independence of the board from management, transparency, an effective risk management system, and a system of accountability.
46. A published study in the US Global Journal of Management and Business Research, on the Link between Corporate Governance and Organizational Performance found strong relationships between a number of corporate governance variables and firm performance measures.
47. Overall, the study examined the relationship between corporate governance and the performance of firms, using reliability of financial reporting, existence of a code of corporate governance, effective audit committee, board size, and separation of office of board chair from CEO as the variables of corporate governance, while return on assets and profit margin serve as proxies for firm performance.
48. According to the study, "Sub-optimal or outright failure of governance systems can be argued to be a major contributor to the collapse of many of the well-celebrated organizations that have littered the world's corporate landscape. This failure, which translates into an inability of organizations to meet the expectations of their various stakeholders, has often been traced to weaknesses in the internal controls infrastructures and operating environments, and a lack of commitment to high ethical standards".

Conclusion

49. In concluding, let me reiterate that International best practice revolves around strong shareholder rights, high levels of transparency and disclosure, and strong and professional boards of directors and stakeholders – all supported by a strong legal and enforcement framework. Good corporate governance can enhance investor trust, attract outside investment, and

demonstrate a country's commitment to observing international standards. Ultimately, good corporate governance contributes to not just stock market development but also the sustainable development of an entire economy since it enhances the performance of a country's companies and increases their access to global capital. Poor corporate governance, on the other hand, weakens a company's potential and may lead to financial crisis.

50. Capital is attracted by returns as much as good corporate governance and best practice. If there is a lack of good corporate governance in a market, capital will leave that market with the click of a mouse. As succinctly articulated by, Arthur Levitt, (Chair of the US Securities and Exchange Commission between 1993-2001) - *"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country – regardless of how steadfast a particular company's practices may be – suffer the consequences"*.
51. As an alumnus of this great school, I assure you that this scenario will not befall Nigeria under my watch. My team and I at the SEC will continue to work hard to improve propagation of best governance practices across our great country. This will be good for companies; it will be good for society and will ultimately catalyze Nigeria's socioeconomic development.
Thank you for your kind attention.