Is it vital to have Corporate Governance Codes for Institutional Investors & Capital Markets? A Case Study of Rwanda

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DATE: 28th MAY 2012

Submitted as part of the requirement for completing an MSc in Accounting and Finance at Karlstad University
ABSTRACT:

There presently is very limited literature and empirical studies that look at the phenomenon and state of corporate governance in Rwanda. Most of the available literature on corporate governance in Africa mainly focuses on South Africa (King Report I, II & III), and not at the emerging economies in the rest of the continent. In particular there has been very limited focus on the implications of having a growing capital market and institutional investors while having no corporate governance mechanisms in place.

The purpose of this research is to examine how vital it is to have good corporate governance codes and an implementation mechanism in Rwanda, in light of the introduction and development of a Capital Market, and the growing presence of institutional investors attracted by both the capital market and the privatization process of state-owned enterprises. It involves a review of literature on corporate governance systems as well as a ground approach done by interviewing two experience professionals who are responsible for the government organizations in charge of formulating and implementing corporate governance codes in Rwanda, as well as investor promotion and protection. Based on my research, I found that Rwanda’s amended Company law is strong on investor protection, but there is a non-existent corporate governance code which leaves room for managers to exploit minority shareholders and stakeholders. From corporate governance studies we are able to establish a positive relationship between good corporate governance and company growth & sustainability, and a negative relationship between bad corporate governance and performance, profitability and sustainability.

The nature of the legal and regulatory framework has been fundamental in shaping the current corporate governance system. However these formal mechanisms have not been very significant in penetrating to the majority of the businesses in Rwanda which are Small & Medium scale Enterprises (SME’s) and private limited companies. The informal mechanisms have played a key role in shaping the corporate governance structure and provided support in creating a sound corporate governance system. This research seeks to explore the role and impact of institutional investors and capital market on their decision-making and whether it is vital to have a corporate governance code in place to limit their actions.
ACKNOWLEDGEMENT

This thesis has been produced during my scholarship period at Karlstad University, thanks to a Swedish Institute scholarship. My sincere gratitude goes to the kind people at the Swedish Institute who provided this opportunity and for the endless support throughout my stay in Sweden.

I would also like to take this opportunity to sincerely thank Samuel Petros Sebhatu for his support, valuable guidance and overseeing the completion of this research thesis. My thanks also go to my entire family and all my friends, for their support and encouragement throughout my postgraduate education.
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CHAPTER I: INTRODUCTION

“With the trillions of dollars that have been wiped out of pension plans and other savings, investors have come to understand they need to pay attention to the governance of corporations — from compensation to board structures. If they don’t, the cost is going to come out of their pockets. They’ve got to be engaged.” Stephen M Davis.

The current literature focuses on corporate governance in mostly developed countries like the United States, United Kingdom, Sweden and South Africa among others where more formal mechanisms of corporate governance have been adopted in the companies and capital market. There is little focus on the role corporate governance plays in developing countries, and whether it is vital or necessary in markets that are not as advanced as those in majority of the western countries, but are prone to similar unethical behaviour. Berglof (1999) notes that a few scholars have tried to look into the issues surrounding corporate governance in developing countries particularly its implication on economic development, promoting employment, and foreign direct investment.

However apart from these few scholars, there are hardly any studies that show the need for corporate governance codes in countries where there are active capital markets and institutional investors, but there is no formal corporate governance regime in place. This research aims to establish whether it is vital to have corporate governance codes in place for institutional investors and for the capital market as a mechanism to control and influence the corporate governance in developing and emerging markets, looking at a case of Rwanda.

In my research thesis I will attempt to answer the question on whether it is important to have corporate governance codes for institutional investors and the capital market. Corporate governance is not something that can be legislated, and though there might be legal and regulatory frameworks in place, this will require more participation from the public and private sectors. Regulators can establish guidelines, but how those taking them are held accountable depends on how companies implement these guidelines, and investor’s reaction to them. (Ananchorikul, 2009) Corporate governance represents the challenges of reform in a world where outcomes depend on market reactions as well as official decisions.
The research thesis is divided into three parts; the first part looks at the theoretical and conceptual framework of corporate governance, while the second part looks at the legal and regulatory framework currently in place in Rwanda and a background on Rwanda as a country and a brief role of the role of privatization in developing corporate governance. The final part of the research thesis is a discussion into the findings of the research, as well as a conclusion and recommendation into the state of corporate governance in Rwanda including proposed guiding principles of corporate governance that can be adopted by public & private companies and implemented by the government in Rwanda with an aim of benefiting from good corporate governance particularly economic development.

1.1 RESEARCH PROBLEM:

It is generally accepted that there is a positive relation between good corporate governance and better performance, growth prospects, higher financial returns and higher stock value. Corporate governance is useful in protecting minority shareholder’s interests; ensure protection of other stakeholder’s rights. In emerging economies, corporate governance is critical in economic development, promoting employment and attracting foreign investment. (Stijn, 2006)

However there higher need for studying the role that corporate governance plays in emerging economies and whether it is necessary to have a corporate governance regime for institutional investors and the capital market that are active in markets where there is no corporate governance code. (IFC, 2011)

1.2 AIM

This research aims to assess whether it is vital to have corporate governance codes for Institutional Investors and the Capital Market, using Rwanda as a case study. The reason for using Rwanda as a case study is that Institutional Investors are active in the Capital Market, but Rwanda as a country has not adopted or formulated any Corporate Governance code.
1.3 OBJECTIVES & RESEARCH QUESTIONS

This main objective of this research is to describe and understand the necessity of corporate governance codes in the presence of a capital market and institutional investors, and to develop a guide of corporate governance codes that can be implemented in Rwanda.

To achieve the objective of this thesis, the following two research questions are considered.

- What is the importance and need for corporate governance codes for institutional investors and the capital market?
- How can Rwanda develop a standard corporate governance code as well as ensure ethical behaviour by institutional investors and management?

1.4 RESEARCH METHODOLOGY:

This section describes the research approaches used and applied in this thesis. The methodology is primarily based on qualitative research, and case study approach and narratives have been used as specific methods to investigate the state and approach towards corporate governance in Rwanda by the government agencies and companies.

Qualitative research has been used for this research thesis, and it is described by Cassel and Syman (1994) as “a focus on interpretation rather than quantification; an emphasis on subjectivity rather than objectivity; flexibility in the process of conducting research; an orientation towards process rather than outcome”. Qualitative research is also described as “naturalistic in that, the researcher enters the world of the participant(s) as it exists and obtains data without any deliberate intervention to alter the setting” (Locke et al 1987). Qualitative research methods have often been frowned upon as un-scientific, or journalistic or exploratory work. However it should be noted that qualitative research acts as a complimentary for quantitative research thereby providing more synergy and opening more approaches (Mayring, 2001).
Research Method – Case Study:

Yin (2012) notes that case study has multiple meanings, and can describe a unit of analysis or a research method. In this instance we are looking at case study as a research method, as described by Yin (2012) it refers to “an empirical inquiry about a contemporary phenomenon (e.g. a “case”), set within its real-world context – especially when the boundaries between phenomenon and context are not clearly evident”. The case study is the best method to use in this case as it addresses the descriptive question “Is it vital to have corporate governance codes in Rwanda?”

The case study is the best suited for providing a rich description and insightful explanations into this nature of research. The reason I chose case study for my thesis is that it allows and provides for thorough investigation in answering cause and effect questions. The justification for using case study is that it provides multiple sources of evidence and variant of interviews through non-structured / open-ended interviews. In my study, this is the most appropriate method since the ultimate goal of a case study is “to uncover patterns, determine meanings, construct conclusions and build theory (Applebaum, 2003).

There is also a component of field research which is used for obtaining insight based on knowledge of individuals.

1.5 DATA COLLECTION:

Yin (2003), points to six possible sources of data for case studies; documents, archived records, interviews, direct observations, participant-observation and physical artefacts. The data collected was both primary and secondary data. Primary data is described as that collected by the researcher through methods like direct observation, surveys, interviews and logs (e.g. fault logs, error logs, complaint logs, transaction logs). Secondary data is described as data collected from external sources such as various research articles, previous studies, books, reviews, magazines, internet search engines, TV, and radio amongst others. The primary data was collected through a combination of interviews and questionnaires and is qualitative in nature. The secondary data was mainly obtained from electronic sources, and is also qualitative in nature.
1.5.1 Primary Data:

Primary data was mainly gathered through interviews and use of documents relating to the law in force in the Republic of Rwanda. In this research thesis, the primary data was collected through elite interviews (with high-ranking government officials), and questions (Appendix 1) were based on the theoretical discourse of the subject. The nature of the interview questions was open-ended and the respondents were valuable because they hold unique positions and provided insights and information that would likely not be obtained from other sources. This method of data collection required holding phone-interviews with the respondents who are based in Kigali, Rwanda. After initial contact was initiated using personal contacts with the respective government officials, phone calls were made to the two people heading the respective government departments that are responsible for the matters related to Corporate Governance in Rwanda and over the course of an hour and a half several various areas of the subject were discussed and it was agreed that the questions be sent in written form so that more structured responses could be provided.

The phone interviews were carried out on 8th and 9th May 2012. The first interview was held with the Chief Executive Officer of the Private Sector Federation focused on the role of the private sector as an engine of the development of the economy and how corporate governance is incorporated into these companies, the monitoring and continued advice provided to companies to ensure continued good governance. The interview lasted an hour, and a follow up was done by email.

The second interview was held with the Senior Investment Promotion Officer at the Rwanda Development Board mainly discussed the implementation, policy formulation and monitoring role on the part of the government. The interview lasted forty five minutes only as the respondent was leaving the country on official business and did not have enough time to have a longer interview. In both cases the researcher contacted the interviewees again by email to clarify on some of the details necessary for the analysis. The questions were semi-structured to let the interviewee provide more flexible answers from their own point of view and in the context of the topic being discussed. Prior to each interview the researcher had done background work on each
of the organizations and their responsibilities using secondary sources including the websites, internet media and print media.

Other sources of primary data included the use of laws of the Republic of Rwanda. The three used in this thesis include the Company Law (amended in 2009) which was accessed from the Registrar General’s office, the Law Relating to Capital Markets and the Law Relating to Collective Investment Schemes which were accessed from the Capital Markets Authority Act website (www.cma.rw). These are all current laws that are in force as of the time of writing this thesis.

1.5.2 Secondary data;

The majority of the secondary data was collected from online sources. Four textbooks used were from the university library and from the academic bookstore; direct sources were also used for information particularly from government of Rwanda agencies where no personnel could be reached and the president’s office for archived speeches, press releases, company and annual reports. Over twenty different journals used were obtained from databases including Science Direct (where I got 9,954 journals / hit for corporate governance), EBSCO, Sage (where I got 10,979 results / hit for corporate governance), JSTOR (where I got 9,329 results / hit for corporate governance), and Wiley (where I got 28,700 results / hit for corporate governance).

The search also widened to look for new information in a wider area so as to get wider understanding of the research gap. At later stages I used Google scholar to access a wider number of online journals and commonly cited articles and publications. Google scholar provided up to 987,000 results on corporate governance, but zero results on the search “Corporate Governance in Rwanda”, similar to all the other databases used.

1.6 DATA ANALYSIS:

Hartley (1994) mentions that data collection and analysis are developed together in an iterative process which can be a strength as it allows for theory development which is grounded in empirical evidence. Yin (2003) describes data analysis as a search for patterns in data.
For my research thesis I have used a **general analytic strategy** which provides different techniques and relying on theoretical propositions which have formed the design of the case study. The data analysis has been carried out using **pattern-matching logic**. Trochim (1989) notes that this logic compares empirically based pattern with a predicted one (or with several alternative predictions). If the predictions coincide, the results help a case study to strengthen its validity. In the case of explanatory case studies, patterns may be related to dependent or independent variables of the study (or both). Using pattern-matching logic, there are key words I noted from the theory on corporate governance which I was looking for in the responses provided from my interviewees. Examples of key words were **investor confidence, economic growth, sustainable growth, shareholder protection, and capital market growth**. My analysis also involved the use of **explanation-building techniques** as from the responses from the interviews and the theories I was attempting to build an explanation on why it is important for a country to have corporate governance codes in place.

In my research thesis, the dependent variable was the corporate governance codes, and the independent variables were the institutional investors and the capital market. From the interviews analysis I classified the information from the respondents into three categories; importance of, need for and the challenges.

Kohlbacher (2006) mentions that **theory-guided analysis**, is one of the special strengths of qualitative content analysis. The central idea is that researchers constantly compare theory and data – iterating toward a theory which closely fits the data. It also offers a chance to compare and complement the primary data collected within the research project, with the secondary data.

**1.7 TRUSTWORTHINESS:**

This research underlies on the assumption that the information provided is valid and that the appropriate method of research has been used. One of the requirements for a research paper is that it is reliable, and the readers regard it as trustworthy (Gummesson, 2000). Using the qualitative method of research, reference is provided for the different resources used for material, the analysis method, and credible sources are used as the basis for the information used in the discussion and analysis section of this research. The purpose of the research has been to create an in-depth understanding of the corporate governance situation in Rwanda with particular focus on
the institutional investors and the capital markets, and how the existing legal and regulatory framework is used to enhance corporate governance. In collecting and analysing this information I have taken into consideration all ethical issues, especially in the process of carrying out the interviews.

Validity and reliability are traditional key criteria that govern the process of measuring and collecting data. It is widely accepted that methods of measurement should be as objective, reliable and valid as possible (Diekmann, 2003). Mayring (2003) notes that since arguments concerning the content are judged to be more important than methodological issues in qualitative analysis, validity takes priority over reliability. A lot of effort has been put into consideration in ensuring that the information presented in this research is valid and up-to-date as of the time or writing this research thesis.

1.8 LIMITATIONS:

The researcher believes that the chosen case-study method was the appropriate method to employ in conducting and collecting data for this research. The research is limited because it provides information about the state of corporate governance in Rwanda particularly looking at institutional investors and the capital market. The limitation is that all of these factors are new to Rwanda and therefore there is very limited secondary information and the number of government officials responsible for corporate governance is also limited in number.

1.9 STRUCTURE OF THE THESIS

Chapter I is a brief introduction that covers the background to the study, statement of the problem, justification of the study, research questions as well as the objectives of the study, the scope and rationale of the research.

Chapter II discusses the theoretical and conceptual framework, critically analysing the existing literature on corporate governance, the structure of corporate governance codes, need for the research proposed as well as an in-depth coverage of the relevant theories regarding the role of institutional investors in corporate governance particularly the tools used internally and externally as corporate governance controls.
Chapter III provides background information about Rwanda and the state of corporate governance in the country. It also provides an analysis into the legal and regulatory framework currently in place specifically the Company Act and the Capital Markets Act and their contents and depth and whether these are strongly formulated to ensure investor protection in the absence of a corporate governance code.

Chapter IV provides an analysis into on institutional investors and the capital market in Rwanda. This includes an attempt to establish whether a corporate governance code is needed for these categories of the financial sector by observing the monitoring tools used on them, and speaking to key personnel at the Private Sector Federation and the Investment Promotion & Implementation Department of the Rwanda Development Board. The chapter also looks at the privatization law and the role it plays in creating institutional investors and the growth of the capital market.

Chapter V will use the analysis from previous chapters to discuss the future of corporate governance in Rwanda and the key areas that need to be addressed in order to make corporate governance more effective. The recommendations and in-depth conclusion are in chapter VI.
CHAPTER II: THEORETICAL AND CONCEPTUAL FRAMEWORK:

2.1 Corporate Governance

OECD (2004) describes corporate governance as a set of relationships between the management of a company, the board of directors, the shareholders and other stakeholders (internal and external). It also provides the structure through which the objectives and goals of the company are set, how they are to be attained and measuring performance.

O’Donovan (2007) states that corporate governance can be defined as an internal system that encompasses policies, processes and people, serving the needs of shareholders and other stakeholders by directing and controlling management decisions with objectivity, accountability and integrity. Good corporate governance relies on commitment to legislation and safeguarding policies and processes.

Corporate Governance can be defined as a framework that directly impacts on the way a company or organization is controlled and directed. It helps in defining the relationships between the key players in the management of the organization; the key players are the Board of Directors, shareholders and the management team (agents). Other stakeholders might include employees, suppliers, creditors and government regulators among others.

Berle and Means (1932) emphasized that the importance of corporate governance is to ensure continued transparency and accountability in companies, and to reduce the risk of agency problem between the shareholders and management (principle-agent) that may arise from the separation of ownership and control of the company.

Some of the tools that corporate governance relies on in ensuring transparency and accountability are internal and external controls. These may include Board of Directors, Audit Committees, Corporate Social Responsibility programs, Board sub-committees among others.

2.1.1 Institutional Investors

Institutional investors can be described as entities such as investment banks, mutual funds, insurance companies, or brokerages that accept and invest third parties funds into the financial markets by purchasing securities like shares, options, or bonds as well as in non-financial
profitable assets like real estate on behalf of the third parties. Institutional investors pull several savings from different individual’s savings and invest these sums in different portfolio with the aim of making big profits.

OECD (2011) states that Institutional investors are a major force in many capital markets, and their main goals are to optimize returns at targeted levels of risk, and diversify their investments into large portfolios in several companies.

2.2 Principal Parties to Corporate Governance

The principal parties to corporate governance include shareholders or owners of the business who are also referred to as “Principals”, and management of the company who are also referred to as “Agents”. The management of the company can refer to the senior management personnel like the Chief Executive Office, Chief Finance Officer, Chief Operations Officer, and Chief Marketing Officer among others. There are other stakeholders like employees of the company, customers of the company, the society where the company operates, suppliers and creditors among others.

The “principal” delegates the power of authority to the “agent” to run the affairs of the company in the best interests of all shareholders. Jensen and Meckling (1976) emphasize that because the relationship between the owners and management is of a principal-agent nature, it could lead to a problem of conflict of interest between the two parties due to different view on the company objective or how to achieve those objectives. The main objective of the principals is profit maximization, whereas the agent will have the objective of maximizing rewards from the company.

Berle and Means (1932) highlighted on the separation of ownership and control, stating that as country’s economies developed and with industrialization, there was a clear separation of ownership and control, particularly in the USA and UK where there were legal provisions to protect minority shareholders. Managers might not always act in the best interests of the shareholders, and therefore separation of powers ensures that there is a reduction in the influence of manager’s decision-making powers and this is in the interest of the shareholders. In circumstances where there are several small shareholders they might not have enough power to
curtail the powers of the agent which might be disadvantageous to them in case the agent places self-interest before those of the shareholder.

This separation of ownership and control makes it imperative for having a corporate governance framework in place that will ensure accountability and transparency between the agents and principals. These mechanisms will check the excesses of the management and ensure smooth running. In the last 30 years most ownership of company’s equity is held by institutional investors as opposed to individuals and this has helped reduce on the cases of agent-principal conflict.

The Board of Directors plays an important role in the corporate governance structure, by setting strategic policies that the company will take. The Board has powers on behalf of the shareholders to hire and fire the right personnel to run the management of the company, and where they feel the management is not achieving the set objectives and goals of the company they have the powers to overhaul and replace the entire management team.

O’Donovan (2007) states that a company’s corporate governance code greatly contributes to its share price and ability to raise capital. A company with a good corporate governance code will have a high stable share price. The quality of a corporate code is determined by legislation, financial markets, internal processes and policies.

The role of Company Secretary is also essential in the corporate structure of any organization, since this position is directly responsible for ensuring high standards of ethics and corporate governance are adhered to. Additionally the Company Secretary ensures that policies and procedures are adhered to as stipulated by the board, as well as ensuring that these policies comply with the country’s legislation.

All principal parties in the organizational structure of a company have a direct or indirect interest in the performance of the company. Once a company is well run, all the parties involved will benefit from the reward of the growth and success of the company. The agents will receive remuneration and bonus and other benefits, whereas the principals will benefit through increased return on investment and higher share prices. Creditors will receive payments for their goods and services whereas consumers will be guaranteed of high quality products and services.
In deciding what companies to invest in, most rationale investors will thoroughly look into the corporate governance practices of company’s before they decide to invest in them. The presence of a good corporate governance structure guarantees that agents will carry out their duties in an honest and transparent way, and therefore the investor will be able to receive a good return on his investment. (OECD, 2004)

One of the main reasons why corporate governance is required is the “Agency Theory” or the potential conflict of interest that might arise between different parties in the corporate structure. These parties may include the Shareholders, who are usually referred to as the ‘Principals or Owners’ and Managers or Executives, who are referred to as the ‘Agents or Controllers’. Conflicts of interest may arise due to the assumption that the shareholders and managers have different objectives and interests as to which direction to steer the organisation. Additionally, either of the parties may have and take action based on wrong information as to each other’s objectives, which may significantly affect the company (Gillan and Starks, 1998).

Berle and Means (1932) examined the separation of ownership and control as a measure to the Agency theory, and expounded on the fact that if managers are not properly monitored and their decisions checked may act in a way that satisfies their self-interests first above those of the shareholder. However in most companies, the manager’s powers are governed by internal control mechanisms like the Board of Directors, as well as external controls like other players in the market.

One of the most important factors affecting corporate governance and company management is the emergence of Institutional Investors. These institutional investors have the financial power to enable to strongly influence management’s decisions and activities by sheer number of shares they hold in a company or by trading their majority shares in a company which greatly impacts corporate governance. (Gillan and Starks, 2003)

These institutions have vast financial resources at their disposal, which they use to buy large numbers of shares in companies and can use this position to influence management decisions in their favour and not with the interests of other shareholders or the long term sustainability of the company. Most of the decision-influencing is to ensure that in the short run profits are made. Institutional investors use methods such as deciding not to commit re-investment funds, or by
increasing the cost of capital in a company which directly affects its operations. To avoid this scenario, management does as the investors dictate.

Institutional Investors is a term used to refer to organizations that invest individual’s funds, say savings and pensions, into the financial market by buying securities like shares and bonds, and assets like commercial buildings with the aim of making a profit on these investments. The best examples of Institutional Investors are Banks, Insurance companies, Pension Funds and Mutual Funds.

Corporate governance can be defined as a set of relationships between different participants in an organization, according to the Organization for Economic Development (OECD) (1998). These participants may be Management, Board of Directors, Shareholders and creditors. Corporate governance provides the structure through which a company’s objectives are set, the ways in which they will be attained and the monitoring of their performance is determined.

Marnet (2008) defines Corporate Governance as a tool which deals with the methods which investor financial organisations employ to create certainty of deriving returns on their investment whereas Keith Redhead (2002) states that it is concerned with the companies that are controlled.

Keith Redhead (2002) asserts that the concentration of a large proportion of shareholdings and equity in the hands of a small number of institutions has made it possible for them to exert excessive influence over the management of the investee companies, especially since over the last thirty years individual ownership has significantly reduced, and institutional investors have become majority shareholders in the equity markets.

The impact of the institutional investors on the investee companies is rather controversial, as some scholars argue that they possess and use excessive influence and this positively or negatively affects these companies.

Mallin (2007) emphasises that institutional investors’ potential to exert influence on management has direct implications on the Corporate Governance practice, particularly in terms of the standards and legal issues.
2.3 Principles of Good Corporate Governance

Johnson et al (2000) note that company success, sustainability and growth are strongly supported by implementation of good corporate governance practices. As a result of the financial crisis in the last 20 years starting with the 1997-98 Asian Financial Crisis and the US Corporate financial crisis in the early 2000’s, which saw the collapse of several large corporations like Enron and WorldCom, it is now essential for companies to have in place effective and well-designed corporate governance structures in place.

OECD (2004) advocates for corporate governance by noting that it is important that all parties in the corporate structure perform their duties diligently in order to ensure that their company’s competitiveness in the market is secure and in this way the companies are able to attract external funding from institutional investors which in the long run will reduce the cost of capital. The need for accessibility to capital is a key requirement for the growth of all companies, and in this regard both the principal and agent are mutually expected to behave in a diligent ethical manner to ensure the company’s funding is not hampered.

There is no single good model for corporate governance, however there are common principles that underlie good corporate governance and can be embraced in different models of corporate governance codes. These common principles have been adopted by several countries that fall under the OECD including among others Canada, France, Germany, Sweden, United Kingdom, United States and several other nations. According to the OECD (2004) Principles of Corporate Governance, the internationally acceptable benchmarks set for corporate governance are listed into 12 principles that are;

Ensuring the basis for an effective corporate governance framework; an existing framework should be used as an instrument to promote and ensure transparency and market efficiency, while ensuring that the existing laws are being respected and obeyed and articulating a clear separation of roles between different key players like regulators, supervisors and the enforcers. The framework should have an impact on the economic performance and benefit all the players in the market.
The Rights and equitable treatment of shareholders; the corporate governance framework is intended to safeguard the rights as well as ensure the equitable treatment of all shareholders. These include the rights to buy or sell shares, obtain any required information in a timely manner, participate in shareholder meetings, have an input in board member voting process, and receiving dividends on company profit. Management should ensure that financial information is available to all shareholders so that investor confidence increases, and to show that management is working in the interest of the shareholder. Management and Board should inform all shareholders in the case where key changes are made such as amendments to statutes or articles, extraordinary transactions or issues affecting share value or share price. Additionally, all shareholders including foreign and minority shareholders should be treated equally. Minority shareholders should be protected from any direct or indirect threats by controlling shareholders, strict prohibition of insider trading, and declaration by board members or executives in any transactions where there might be a conflict of interest. All these actions promote transparency and accountability within the organization. (OECD, 2004)

Role of other stakeholders; corporate governance encourages and recognizes the role of other stakeholders in directly or indirectly creating jobs, wealth and in the overall performance of the company. These stakeholders including suppliers, employees, and creditors have their own interests as well, and have rights established by the law which need to be protected. Company management has to ensure that these interest are recognized, and disclosure in important so that stakeholder confidence in the company is increased. (OECD, 2004)

Disclosure and Transparency; companies must ensure that timely and accurate information is provided to all interested parties in regards to the financial performance, periodic financial and audit statements, company performance, ownership and governance among others. Companies must uphold the right to disclosure by providing information to stakeholders about board remuneration, selection process of board members, and their independence.

Annual audits should be carried out by independent and competent professionals to provide an external assurance to board and shareholders that the financial statements provided show a true and correct position of the performance of the company.
Companies should ensure that resources are provided to board members so that they can perform their duties efficiently and make sound decisions. Declaration of dividends, if any, should be informed to all parties and regular meetings are held to keep all stakeholders and shareholders informed of all key decisions made.

There should be a mechanism in companies to address financial analysis or provide professional advice from brokers or analysts to help investors with decision making, free from the conflict of interest that may be provided by company sources.

Integrity and Ethical behaviour; Corporate structure (from the shareholders) to the board of directors and management are expected to uphold the highest standards of integrity and ethical behaviour.

Analysing the collapse of Enron and other corporate failures that started in the early 2000’s, it was clear that the management specifically the Chief Executives and Finance personnel, as well as internal and external auditors displayed high levels of unethical behaviour by falsifying accounting reports thereby giving poor financial reports to shareholders and management giving manipulated reports that reflected a good financial picture and a good profit. The collapse of Enron led to thousands of job losses, loss of investor’s funds, a domino effect on other companies that were inter-linked to Enron, civil suits against senior management of the companies, and record bankruptcy declarations. All these would have been avoided if there was a strict adherence to integrity and ethical behaviour by the management, auditors and board members at Enron and other companies.

Responsibilities and Roles of the Board of Directors; The strategic running of the company, the monitoring of the decision-making of the management, and the accountability of the board to all shareholders and stakeholders are some of the key responsibilities of the board stipulated in the corporate code. Board members are obliged to act in good faith and with due diligence in safeguarding and ensuring the best interests of the company and the shareholders are always put first in all the decisions being made. The Board of directors has powers to hire and fire the ‘agents’ depending on whether there is unanimous support that the management is not performing to the best of its ability, or acting in a manner that may affect the interests of the shareholders. However, the board should not misuse these powers to their own interests, and
rather are urged to have knowledge and in-depth skills in their actions particularly in regards to managerial performance management. In executing its duties the board is expected to be irrational and have no bias, act with due diligence and care, treat shareholders fairly, and practice high ethical standards. (OECD, 2004)

Briefly, the key functions of the board include; responsible for the corporate strategy and direction, formulate action plan, review annual budgets and business plans, monitoring and setting performance measures, responsible for all major capital expenditure and acquisitions. The Board is also responsible for the process of recruiting and relieving senior executives, monitoring their performance, and their remuneration. The board also is responsible for amicably resolving any conflicts that may arise between senior management, members of the board and shareholders. The board also has the responsibility of ensuring that financial statements produced by external auditors are accurate and appropriate internal controls are in place in the company so as to maintain the integrity of the company.

2.4 Corporate Governance Mechanisms;

In order to have an effective corporate governance system, companies need to have several mechanisms and controls in place. These mechanisms will act as checks and balances to all the parties in the corporate structure to reduce on inefficiencies and potential conflicts and to enhance growth. Such mechanisms like the use of board of directors ensure that financial information provided by the company to shareholders is accurate.

Corporate governance controls or mechanisms can be put in two categories; internal and external mechanisms.

2.4.1 External corporate governance mechanisms or controls;

These can be described as the mechanisms that external stakeholders can use to control or exert their influence on the management of the company. These controls are out of the power and reach of the senior management of the company. External controls are critical and important in corporate governance because they ensure that external stakeholders have mechanisms to monitor those who have the power to run the company, and these mechanisms cannot be used in favour of the management.
Examples of external corporate governance mechanisms include;

External Auditors; External auditors are very crucial to the financial structure of any company, and they are a control to check and certify that the financial reports produced by internal auditors reflect the true position of a company’s financial position. The view of the external auditor is highly regarded by both the board of directors and external stakeholders including government agencies like the tax authority. The external auditors report will show whether a company’s internal controls are adequate and up-to-date, the compliance with fiscal regulation, and whether financial reports are following the latest international accounting standards. (Marianne, 2009)

External market competition; One factor beyond the control of the management is competition from other firms in the market. This is beneficial to the customers in that competition encourages innovation, variety, and quality which are all beneficial to the customers in the long-run. Competition forces companies to enhance their quality both internally and external outlook (branding, advertising, etc.) as a measure to gain a competitive advantage over all the other competitors. The end result is having a well-run and efficient company. (Singh, 2003)

Government Regulation; Government regulations play a key role in acting as controls in checking the powers of the management of the company and in investor protection. Key legislations ensure that companies make statutory tax payments, practice good corporate governance practices like fair employment practices like gender balancing when recruiting, as well as ensuring companies do not practice fraudulent practices. Government legislation also requires companies to use auditors (tax audits, and external audits). Government regulations also ensure that companies remit pension amounts on behalf of their employees thereby protecting them from losing their future pension. (Coglianese et al, 2004)

Other mechanisms include the requirement by law for public companies to present their financial reports in the media (newsprint), the requirement by financial lending institutions to analyse company financial reports before providing additional funding.

2.4.2 Internal Corporate Governance Controls;

These are mechanisms that are put in place by the board of directors on behalf of the shareholders as a mechanism of regulating and checking the management’s actions so that there
is no diversion from the set goals and objectives of the company. These internal controls also ensure that there is no abuse of power by the management for personal gain (for example misuse of company assets, embezzlement of funds, or fraud practices), and to ensure there are minimized financial losses that the shareholders are exposed to.

General internal controls that are applicable in many companies include;

*Internal Audits:* the role of internal audits in a company is to test the internal control systems and to find where there might be “holes” that need to be plugged. Internal audits are also used to find out if the financial reporting applied by a company is the most recent, and if it is being complied with. Financial regulations vary in different countries, and therefore the company’s internal auditors should be in position to advice on which standards and regulations are applicable in that particular country. Internal audits are necessary in companies, because they determine whether financial reports that are presented to the board by the accounting department provide the right information and also act as the point in detecting fraud that might be happening in the company. (KPMG, 2003)

*Remuneration, Benefits and Bonuses:* Agents are employed to run companies on behalf of the shareholders / owners, and one of the best ways to keep them motivated is through the remunerations, benefits and bonuses provided. These are mostly performance-based, and the level of profits made by the company in a particular financial year will determine the level of bonuses or benefits that the “Agents” will receive. These benefits can either be in cash or non-cash payments (for example share stock). However, these are known to be both a motivational factor and a de-motivational factor and it might have a negative backlash and create opportunism. (Dicks, 2007)

*Separation of powers:* internal controls ensure that there is separation of powers within the company. The Chief Executive Officer (CEO) will not be the same individual as the Chief Financial Officer (CFO) and therefore there will be minimal chances that the CEO can assume powers of the CFO to fraudulently access company funds. Other internal controls like the internal and external auditor will also check that financial transactions follow all required procedures. (Coglianese et al, 2004)
The role of the Board; another internal control mechanism is the role the board plays in the running of the company. The board plays a key integral part in the success of an organization since it ensures that the set objectives and mission of the company are followed consistently by the management. To facilitate this mandate, the board has the right to recruit and replace the management team if it is convinced the management is not achieving the expected results. The board has the key role of protecting the investor through approving key management decisions that might affect the shareholder, ensuring that investor returns increase year on year, and as well as ensuring that management actions are monitored and management powers are restricted. (OECD, 2004)

As it is in most companies, the board is required to meet regularly with the management regularly to discuss pending issues in the company, and decisions that have been taken by management and those that need to be approved.

The role of the board is to take key strategic decisions in the interest of the company, and ensure that the management implements these decisions and objectives. In this regards, a company can have an effective corporate governance system only with the full support of the board of directors.

2.5 The Role and Structure of Institutional Investors in Good Corporate Governance

OECD (2011) notes that whereas there is generally an assumption that shareholders will look out for their best interests as long as they are provided with the right information and their rights are protected. However with a rise in a new breed of highly skilled and well-funded professional investors who have unique costs, benefits and objectives there have been changes in the source of influence exerted on managerial discretion and decision-making.

Mallin (2010) explains that separation of ownership led to agency problems between the owners and management. But over the last century the ownership structure in most companies in the West changed from small individual shareholders to institutional share ownerships. OECD (2011) estimates that by 2009, institutional investors managed USD 53 trillion of assets in the
OECD area only. They are therefore a huge force in many capital markets around the world by sheer virtue of the funds and investments they control.

Some scholars have looked at the agency-problem that arises between the agents and the principal, and how this conflict has led to the rise of institutional investors strongly having an influence on the actions of the management. Jensen and Meckling (1976) noted that the agency problem arises from the agent and principals having different interests in regards to the objectives of the company, the need for cost on the part of the principal in monitoring the agent as well as ensuring that the agent maximizes the profitability on behalf of the principal. Keith Redhead (2008) emphasizes that when the savings of several individuals are concentrated in a single investment institution, it makes it possible for this institution to exert influence on the investee company, and this has had a direct and indirect impact on the role of corporate governance.

Jensen (1993) states that in the early 1990’s after capital markets were affected by the downturn in mergers, acquisitions and other corporate activities, the large shareholders (individuals or institutions) had to turn to internal mechanisms as a way to participate in the company’s strategic direction.

Gillan and Starks (2000) argue that it is only the large shareholder who has the initiative and the ability to carry out monitoring and other costly control activities. The smaller shareholders will “free ride” and will benefit from these activities even without bearing any cost. The larger shareholders will have an incentive to do this because their returns will be bigger, and able to cover these control costs.

OECD (2011) notes that the danger in institutional investors mainly pension funds and mutual investment schemes is that majority of them are short-sighted and are driven by currents earnings of a stock and liquidity of the particular company, rather than the long-term outlook or sustainability of the company. Rajgopal and Venkatachan (1997) state that this short-sightedness changes the priorities of the institutional investor from the way in which the firm is governed, to monitoring the agents which leads to higher costs and this eventually affects the firm’s profitability.
In Rwanda, the Capital Markets Authority is responsible for ensuring that publicly listed companies have good corporate governance practices in place. Despite the lack of an official corporate governance code for the country, investors are guaranteed protection through the Company’s Act, the Capital Markets Act and the Law Regulating Collective Investment Schemes in Rwanda (the category responsible for institutional investors).

Whereas the Capital Markets are developing in Rwanda and much of East Africa, there are steps in place to ensure that high standards of ethical practice are observed while at the same time emphasizing low compliance cost.

2.5.1 Institutional investors’ role as monitors;

Berle and Means (1932) in their study about agency theory emphasized that they arise as a direct result of the separation of ownership and control. Roe (1990) however states that it is not only the separation of these two functions that solely cause agency problems, but also the nature of the ownership can be a cause as well. The structure of the capital markets allows for many shareholders who hold small equity and therefore there is no incentive for any one of them to monitor the activities of the management, which is costly.

Whereas all shareholders benefit from the active monitoring of management activity, only the large shareholders (individual and institutional) have the capacity and financial ability to carry out such an activity. They also have the incentive to carry out these monitoring activities due to the large investments that they have made into the company’s as noted by Schleifer and Vishny (1986).

Studies show a positive relation between shareholder participation and company performance. Kang and Shivdasani (1995) state that active shareholder participation led to stringent controls particularly in cases involving management turnover and associated compensation where stringent controls were put on the terminal benefits for fired management. This in turn helped on saving company resources.

The financial regulations of different countries determine the level of institutional investor’s role as monitors. In some countries like the United States, banks are not allowed to be investors in companies to which they are lenders. Fama (1985) points out that credit information which is
required of borrowers is used by banks before investing, and this gives them an unfair advantage over other investors.

2.5.2 Institutional investor’s role in communicating information;

A key role institutional investor’s play is that relaying information to players in the market including potential investors as well as the markets themselves. In some cases where institutional investors have confidential information that may have adverse effects on the company itself or the shareholders, it is imperative that they act ethically in the way this information is communicated. As explained by John and Chidambaran (2000), sensitive information can cause investor panic that causes company stock to lose value over a very short period of time.

Keith Redhead (2008) notes that the actions of large shareholders like institutional investors and their behaviour can have adverse effects on the stock market and lead to a stock crash or stock bubble. In the event that an institution expects a particular share price to surge upwards, they will rush into the market and make mass purchases of available shares which will lead to stock bubble and should institutions expect a sudden fall in the price of a share they will rush to the market to quickly sell of the large quantities of shares they hold in order to avoid making a loss. This will in turn lead to a stock market crash.

The actions of investors therefore directly or indirectly influence the way other shareholders make their decisions, basing on the fact that the large shareholders normally hold “inside information”, and pay more attention to the management activities.

2.6 Tools used by Institutional investors in corporate governance.

Mallin (2010) states that the role of institutional investor activism is not to micro-manage the affairs of the company, but to adhere to procedures that have been designed to ensure that shareholders gain value from their investments, and are able to deal with any related to the company’s underperformance. The Institutional Shareholders’ Committee (ISC) recommends that institutional investors should have a clear statement of their policy and how they intend to carry out their responsibility, regular monitoring of company activities in an effective way that is
communicated to other shareholders, intervention (where necessary) and where it involves matters like strategy, performance, acquisition / disposal, management accountability, failure of internal controls among other key issues.

Mallin (2010) gave five tools that can be used by institution investors to exert influence on company management. These include one-on-one meetings, voting, shareholder resolutions, focus lists and rating systems.

*One-to-one meetings;* A key tool that is very effective and important is direct meetings between the company management and the Board of Directors and shareholders. In this case, a direct meeting between institutional investors (on behalf of shareholders) and the company management help in eliminating a communications gap, and creating a good rapport between the two parties and is a forum where the highest levels of both parties attend thereby a good place in which to raise issues regarding the company’s objectives.

This is one way in which individual investors are at a disadvantage, because company management will go to lengths to organize such meetings with their large shareholders who are in most cases institutional investors.

Companies that hold regular one-to-one meetings have a better performance because issues that arise between shareholders and management are amicably addressed, objectives and strategy are agreed to by both parties, and staff motivation is high because their grievances are addressed at such meetings.

*Voting / Annual General Meetings;* another tool used by investors is the right to vote as a way to exert influence on the management. Institutions by use of voting powers can pressure the Board to prioritize their interests, vote for replacement of the Board of directors or the management. Voting rights are allocated according to number of shares, and therefore the institutional investors wield a lot of power by virtue of their large number of shares.

Institutional investors can use their voting rights at Annual General Meetings (AGM’s) to vote for, abstain or vote against board proposals. If issues are not amicably resolved “behind closed doors”, the big investors will use their powers to forcefully enforce by either abstaining or voting
against. They can also use these voting rights to place directors on the board that will “monitor” their interests.

*Shareholder proposals / resolutions:* these refer to issues that shareholder’s feel should be discussed at the Annual General Meeting. These concern various issues that could range from employee welfare to social responsibility or environmental impact that the shareholders feel should be address by the board and management of the company. In some countries like the United Kingdom, a certain percentage of shareholders might sign such a petition before it is brought into the AGM. It is expected that with more contentious issues rising in the corporate world particularly executive’s bonuses and other remunerations, together with environmental issues will lead to more shareholder resolutions. Institutional investors by virtue of their share ownership can have these issues addressed faster than small equity shareholders. (Smith, 1996)

*Focus lists:* institutional investors have only recently started using focus lists as a tool of corporate governance. This tool is used where under-performing companies are targeted by institutional investors because of their potential to generate high returns in the short or long term.

Companies that perform poorly in main index are targeted by set criteria, and institutional investors will express interest in the said poorly performing companies and push to have changes in the board and management before they invest their funds in a bid to revive these companies. Dyck & Zingales (2002)

*Corporate governance rating systems:* Since the collapse of several companies after the US Financial crisis of 2002, a lot of global emphasis and focus has been put on corporate governance in order to protect a repeat of such scenarios recurring. Some of the emphasis has led to the use of rating systems in different parts of the world like Deminor in Europe, GMI in the US and parts of the Asia-Pacific, and Standard & Poor’s in different parts of the world. Governments use these ratings to establish the competitiveness of their companies compared to other countries when competing for potential investors.

Rating systems indicate what companies have future potential to add onto its corporate governance, and current additions. Companies with good corporate governance ratings are perceived to be very attractive to investors as they show that the board ensures shareholder’s
interests are taken care of. Rating will take into consideration factors like; accounting practices, board independence and effectiveness, accountability and transparency, shareholder activism and rights among others. (Donker et al, 2008)

2.7 Does Corporate Governance Matter?

It is generally agreed that good corporate practices lead to reduced agency costs in firms, and there is a reduction in inefficiencies caused by conflict of interest between managers, owners and stakeholders, firms have improved competitive advantage over other firms, and there is fulfilment of their social responsibilities towards the communities that they operate in. A company’s objectives are set on the basis of its corporate governance system, and the strategies for reaching these objectives as well as performance evaluation are all based on the corporate governance system (OECD, 2004). Schleifer (1997) notes that having a good corporate governance system ensures firms have access to capital and increased returns.

According to OECD Principles of Corporate Governance (2004), Corporate Governance is a key element in improving economic efficiency and growth as well as enhancing investor confidence. These principles are targeted at investors, stock exchange, corporations and other parties that play a role in development of financial markets.

Empirical studies show that amongst firms, those with good corporate governance practice have lower costs of capital, higher access to financing, and better share values in comparison to those that do not have good corporate governance practices in place. Ho (2003) notes that companies with low corporate governance are high investment risks, and markets and stocks with poor corporate governance are punished. According to investment bank’s (CLSA) research, there is a strong correlation between high corporate governance ranking and financial returns, higher valuations and earnings per share performance in emerging markets of Asia.

Ho and CLSA provide insight into the increasing importance of corporate governance in financial markets of emerging economies, and suggest a correlation between corporate governance and financial indicators. These findings should be used by governments and firm management to enhance the levels of corporate governance to higher standards. Standard & Poor’s uses a GAMMA (Governance, Accountability, Management Metrics & Analysis) to
reflect its opinion of the relative strength of a company’s corporate governance practices as an investor protection against potential governance-related losses of value or failure to create value. It shows that investors are willing to pay a premium for shares in higher ranked companies than in those with a lower governance ranking.

Ho (2003) notes that good corporate governance practice is not a 100% guarantee for the success of a company, but poor governance systems is a definite recipe for organization failure. As noted in the mid 1990’s to early 2000’s when there were corporate scandals, big firm collapses, hostile take-overs, shoddy privatization of enterprises in the communist bloc, and the emergence of institutional investors – there has been an urgent need to assess the way companies are being run and directed. Questionable management behaviour in developed economies has led to financial losses and collapse of major corporations like Enron and WorldCom. There are recent cases like Olympus in Japan where reported losses of $2billion were covered-up, as well as JP Morgan where losses of up to $2billion were reported in Q1 of 2012. These call for the necessity of improved effective corporate governance.

These issues are not restricted to developed countries only, and have occurred in developing countries like Uganda and Kenya in East Africa. Though the bulk of the recorded cases of corporate governance failure have been in the United States, United Kingdom, and Asia, Africa and Latin America have also had their corporate governance failures. Taking examples of the bank failures in Uganda in the 1990’s, International Credit Bank had practically no corporate governance practice and had for Board Directors, including a six-year old child. The Greenland Bank collapse showed that there was no distinction between the management and the board of directors. There was poor governance practices such that by the time the bank collapsed there were insider lending’s amounting to 47% of customer’s deposits. These collapses indicate the failure of the enforcement of the legal and regulatory framework, particularly the fiduciary responsibilities by the central bank. These and other incidents not only affected the capital markets development, but also significantly affected investor confidence in the financial market and the banking system.
CHAPTER III:

This chapter is split into two parts: Part I provides a background of Rwanda, and provides an in-depth look at the existing legal and regulatory framework in Rwanda in relation to corporate governance and these are the Company Law and the Law relating to Capital Markets. Part II discusses the “on-ground” situation in Rwanda currently including interviews with two professionals responsible for investors and corporate governance in Rwanda.

3.1 LEGAL AND REGULATORY FRAMEWORK:

This part looks at corporate governance in Rwanda particularly the company law and capital markets law and their enforcement, corporate governance problems, and the role of codes in ensuring good corporate governance. This chapter will look at where the current mechanisms have failed and further justify the necessity of having corporate governance codes.

3.1.1 Corporate Governance in Rwanda;

Rwanda is a small landlocked country of about 26,000 sq. km, situated in Central Africa. Also referred to as “the land of a thousand hills / mille colline” it has five volcanoes, twenty three lakes and several rivers, some forming the source of the River Nile. Rwanda is bordered by Uganda to the north, Tanzania to the east, Burundi to the south and Democratic Republic of Congo to the West.

The three arms of government namely Executive, Judiciary and Legislature are separate and independent of each other, with the executive arm being led by the President and Cabinet.

Currently, there is no Corporate Governance framework in Rwanda that is applicable to all business entities though there is strong activism for one to be developed and adopted. The Private Sector Federation (PSF) spearheaded this advocacy and produced a code of business ethics. The legal frameworks that are currently in use for the private sector as well as the private sector are the Company Act of 2009, Law Regulating Capital Markets of 2011, and the Law Regulating Collective Investment Schemes of 2011.

It is necessary for countries to have laws and regulations in place so that when other mechanisms are not sufficient to ensure market equilibrium these laws can come in to ensure minimum
fairness and market efficiency. (Ho, 2003). Regulatory bodies establish and implement rules and regulations, monitor compliance and take part in enforcement activities. They play a key role in monitoring shareholders, management, board of directors, accountants, auditors, financial markets and institutions. Rules and regulations are also necessary to ensure there is a proper balance between self-interest and the majority’s interests. It is generally acknowledged that good corporate governance is hinged on sound legal regulation and enforcement.

3.1.2 Company Law;

In Rwanda, the law relating to companies was amended and passed under law number 07/2009. This law was an amendment of the Companies Act of 1988, and was aimed at addressing several shortcomings particularly in regards to corporate financial reporting, corporate structure, simplified business start-up and strengthened minority shareholder protection. The company law lays down the guidelines on company incorporation, distinction between a private limited company and a public limited company, capacity powers and validity of the Act, and shareholder rights and obligations among others.

Article 6 of the company law describes a private limited company as that where there is restriction on the rights to sell or transfer shares, where the number is shareholders is limited to one hundred (employees not included), and its prohibited to invite the public to subscribe for any shares in the company. According to records from the registrar general of companies as of May 2012, there are a total of 14,610 registered companies of which a total of 55 are public limited companies. The majority of companies in Rwanda are private limited companies mostly Small and Medium Enterprises (SME’s) that are individual / family owned.

Even though corporate governance is mainly concerned with private companies and looking out for the interests of minority shareholders not be trampled on by majority shareholders, in this research we focus more on public companies and listed companies on the capital market where there are large institutional investors as well as minority shareholders and the role that an effective corporate governance would play in this relationship. With the increased privatization by the government of Rwanda in the last few years particularly with big companies like the largest brewer and soft drink maker Brasseries et Limonaderies du Rwanda (Bralirwa) where government sold its 25% shares in (128,570,000 shares) to the public through the IPO valued at
US$ 29.5 million as well as the sale of 45% of its shares in Banque de Kigali (BK) to the public through the IPO valued at US$ 62 million. Increasingly, a large number of state-owned companies are being floated on the capital market, and ownership priority is being given to the local citizens as an incentive to ownership of these companies. Since 1998, a total of 56 companies have been fully privatized, 20 in the process of privatization and 7 liquidated, bringing a total of 83 companies that the government has put under the process of divestiture. For individuals to have the confidence to invest in these companies, and for the government to be able to attract foreign direct investment and foreign capital inflow a number of changes had to be made to the legal framework including the company law to ensure that investors would be protected from any eventualities, and thus make the investment climate conducive.

According to the Company Law (Article 14), the key requirements for companies to be registered shall include a memorandum of association, and articles of association. The memorandum of association states the name of the company, physical location, and particulars of any business occupation and the extent of liability for owners of a limited liability, limited guarantee and company with share capital. The articles of association specify the rights, powers, duties and obligations of the company, the Board of Directors, each director and each shareholder. When companies become legal entities through incorporation, there is a separation of ownership and control and the authority to manage company affairs is vested in the Board of Directors. In most private limited companies the owners will double as the management and will occupy the designated roles in the Board of that company and take responsibility for all key decisions and strategy. On the other hand in public limited companies there will be a clear distinction between the roles of the management, the Board of Directors and that of the shareholders. Shareholders use the provision of the annual general meeting to appoint board members, who are entitled with hiring senior management, setting the objectives and strategy of the company, monitoring management performance and implementation of decisions through board meetings.

In Rwanda like most other countries, the Board of Directors of a public limited company will constitute independent and non-independent directors, also referred to as executive and non-executive directors. The key roles of the non-executive directors is to essentially act as a counter-weight against the influence of the executive directors, thereby ensuring that no individual or group can unduly exert influence on the board’s decision. Non-executive directors also make an
overall contribution to the leadership and development of the company. The Rwandan Company Law stipulates that companies must have a board of directors, and gives guidelines on the appointment and removal of directors, but does not have limits on the numbers of executive and non-executive directors that each company should have. Rwanda does not have any legal requirement for non-executive directors although good corporate governance practice would recommend that at least one-third of the board comprises non-executive directors.

3.1.3 Law Regulating Capital Markets;

The law regulating capital markets, also known as the Capital Markets Act was passed in February 2011, following the establishment of a capital market in Rwanda in March 2007. By all intents this is a fairly new and relatively small capital market in comparison with others in the region and worldwide. The purpose of this law is to establish mechanisms for controlling and supervising its activities with a view to maintaining proper standards of conduct and acceptable practices in capital markets.

President Paul Kagame at the opening of the Capital Market said “the capital market will promote corporate governance and improve management practices through their continued disclosure requirements on public companies. Rwanda’s record of governance will also supported further by increased disclosure and corporate governance practices that are promoted by a capital markets environment. The improvement in management will lead to growth in the businesses and revenue to the economy.”

With the intention of attracting local and foreign investors, and using the capital market as one of the most reliable way of selling off of government shares in public companies, the Capital Market Act is strong on regulating activities of listed companies;

Chapter II and III of the Capital Markets Act provide the manner in which regulation of the capital market is carried out. This includes setting out the criteria for the personnel licensed to transact on the capital market, withdrawal and suspension of license, approval or securities exchange or clearing houses, or application as a credit rating agency. In further ensuring compliance of the capital markets in an ethical and transparent manner, guidelines are set out on accepted ethical practices and the punitive action taken where there is breach of these ethics.
These may include but are not limited to written warning, financial fine, court injunction, withdrawal, suspension or termination of license, and disqualification from the profession.

Another important provision that was made is ensuring that players in the market practice the highest levels of integrity and fair dealing with due skills, care and diligence. This includes informing investors on key decisions like price stabilization, protection of property of third parties to which licensed persons act as trustees, making provisions for investors who are brought into bankruptcy proceeding, and well maintained records system.

The Capital Markets Act in Chapter V states out stringent disciplinary measures against unethical behaviour by licensed personnel, as a deterrence against abuse of their power or acting in self-interest. Contravening would be punishable by the Authority issuing a public notice against the offender, a court injunction, or direct intervention by the Authority especially in cases where it is desirable to protect the investor’s interests, or the licensed person has no capacity to carry out capital markets responsibilities. Also prohibited are licensed personnel transacting outside approved limits, engaging in business with unauthorized personnel, or participating in activities prohibited by the capital market.

Another key provision used to maintain ethical behaviour is provided for under chapter VIII that deals with insider dealing and market abuse. Inside information, is described as price-sensitive information relating to capital market instruments that has not been made public, and if made public would have an impact on prices on the capital market. If a person possesses inside information by virtue of his occupation inside the capital market, they are strictly prohibited from using this information in any dealings directly or indirectly for their personal gain. Market abuse refers to persons acting in breach of standards of the market; such as misuse of information, providing misrepresentation of information, or distorting market and capital market instruments.

In further ensuring that the capital market is free of unethical practices, tough financial penalties are in place for persons or companies found breaching the standard practices. Persons operating without a license are liable to a jail term and a fine of between RwF 15,000,000 and RwF 50,000,000 (equivalent to US$ 25,000 to $83,000). Similar fines apply to companies that employ disqualified personnel, and those that issue misleading practices and statements. Offences of
insider trading and market abuse carry a fine of up to $167,000 for the guilty party, and a jail term of up to two years.

3.2: The state of Corporate Governance in Rwanda

An overview of corporate governance in Rwanda is established through interviews with two professionals who head institutions that formulate and implement policies aimed at companies, and who would be the focal point for corporate governance issues in the country. The data was collected through interviews which are useful for getting the story behind a participant’s experience. The interviewer can pursue in-depth information around the topic. Interview may be useful as follow-up to certain respondents to questionnaires (McNamara, 1999).

The respondents to our interview are Mr Hannington Namara who is the Chief Executive Officer at the Private Sector Federation (PSF) in Kigali, Rwanda. He is responsible for all administrative functions of the federation (formerly the Rwanda Chamber of Commerce) and in ensuring the implementation of government policies. The roles of the PSF include providing strong advocacy and voice on sector matters for members, providing an easier and more effective consultation with a more holistic and less fragmented view of industries and establishing a stronger capacity to provide sector specific services.

The second respondent is Mrs Peace Kaliisa who is the Senior Investments Promotion Officer at the Rwanda Development Board. She is responsible for investment promotion, providing information to prospective investors, reviewing of the processes investors go through to register businesses and reviewing processes regarding investment in Rwanda.

These two bodies are responsible for both the private and public sector companies in Rwanda, business registration, investor protection and corporate governance in Rwanda, and are the most suitable and experienced to get information from in regards to the state of corporate governance in Rwanda.
3.2.1 The need for corporate governance in Rwanda:

“We believe that once a company has its governance issues in order, this will attract investors, stakeholders and improve performance. These are the reasons why we advocate for an active corporate governance regime in the country.” – Peace Kaliisa, Rwanda Development Board

One of the main reasons why it is vital to have a corporate governance regime in place in Rwanda is the development of the market-based economy. There are far ranging benefits of this to companies including firms being able to raise equity at a lower cost due to low risk, the supply of equity capital is far beyond what individual resources amount to and outside investors control their portfolio choices and not therefore not interfere in the company’s investment choices. The corporate scandals in the financial world have increased the focus of investors on the way companies are managed. With the growth of the newly established capital market in Rwanda public companies have the option to trade shares to the public and this provides them with greater access to finance, but the stringent demands affect the company, directors, shareholders and advisers. In free markets underperforming companies are targeted by investors who believe they can add more value by gaining control. “The capital market provides the discipline to curb the excesses of managers in check, and companies with poor management practices will be punished by low stock prices. Poorly performing companies can be bought out by mergers or takeovers, and their managers replaced. The rules in the capital markets act and the corporate governance codes would ensure that listing requirements for control would act as a force, and the rules are in place to ensure sound corporate governance” -Hannington Namara, PSF Rwanda.

Minority shareholder protection is another issue dealt with in relation to corporate governance in emerging economies. The lack of weak laws to regulate issues that affect investors such as information disclosure, access to voting rights or enforcement of fiduciary rights. For investors, one of the key tools they use in voicing their opinion is through voting where they use their powers to change management or board of directors if they are not pleased with company performance. In the absence of strong rules to ensure that minority shareholders have access to this right, voting stops being effective as a governance tool. Such hindrances coupled with poor enforcement mechanisms, weakness in the judicial system enhance bad governance which
ultimately hurts the minority shareholders. (Schleifer, 2000) Corporate governance will provide shareholder protection controls like standards on information disclosure especially financial information, directors rights, shareholders rights and voting procedures. “In 2009 we had to carry out reforms of the Company Act in order to take into consideration the protection of the minority shareholders. This is another key area where a corporate governance code would be very critical. However we ensured that the provisions made in the company act were also strong enough to deter the bigger investors from taking advantage of the smaller investors. However there are still challenges to be addressed in this area” – Hannington Namara, PSF Rwanda

In Rwanda as in the rest of Africa, most companies are Small and Medium scale Enterprises (SMEs), and the majority are Family Owned Businesses (FOB). Most FOBs’ in the developing world are less formalized or institutionalized than the small businesses in the developed world. As a result they are very short lived and rarely live beyond the lives of their founders. FOB’s need to institutionalize and become sustainable in the long term beyond the lives of the founders, and one of the key ways is instituting reforms like corporate governance that will separate ownership and control, involve non-executive directors, become more transparent and accountable and respect the rights of all stakeholders. This will enable such companies have access to funding, markets, and labour which in turn lead to increased productivity and growth.

3.2.2 Challenges of Corporate Governance in emerging economies:

“Rules are a good starting point in promoting sound corporate governance in Africa but they are not credible unless they are applied effectively.” – Sam Mensah, 2003

In Rwanda as in most African countries enforcement requires empowering regulators with sufficient authority and resources. In most cases there is reasonable enforcement in terms of board composition and to an extent disclosures have been met. However enforcement is still a challenge and weak judicial systems make offenders get away with light punishments. In some countries the judicial system is plagued by politicization and corruption, low remuneration, poor staffing, and low understanding of the workings of the capital market.

The limited understanding of the workings of the capital market by society, the limited listing of companies, the low investor confidence in financial markets, gaps in the legal and regulatory
framework, and unsupportive macro-economic policies hinders the promoting of corporate governance through the capital market. Majority of the listed companies are subsidiaries of foreign companies with minority shares available for domestic investors. This limits the effectiveness of corporate governance due to limited float.

3.3 Privatization and Corporate Governance in Rwanda:

Boubakri (2005) states that privatization of state-owned enterprises became a global phenomenon in both developed and developing countries, and led to many significant changes in the structure and way corporate governance works. Many governments in the developed world have had large-scale privatizations starting in the early 1990’s, and between 1990-1999 a reported $315.7 billion worth of privatization programs was undertaken in developing countries. By reducing or eliminating their shares in state-owned enterprises, the main expectation is that the efficiency of these firms will increase.

In Rwanda, the privatization process started in 1996 with the main aim of creating a dynamic, export-oriented economy driven by free enterprise. The government systematically made way for private sector involvement in a majority of the state-owned companies that ranged from telecommunications to banking to tea production to tourism. Since 1996 a total of 56 companies have been fully privatized, 20 in the process of privatization and 7 liquidated. This has earned the government a reported RwF 75 Billion (approximately $124million). The objectives of the government at the start of the privatization process were to relieve the financial and administrative burden of government, improve efficiency and productivity of these companies, and reduce the size and presence of the public sector in the economy and broadening the ownership base.

Schleifer and Vishny (1997) argue that governance mechanisms in developing countries are weak and affect the performance of privatized firms. The governance mechanisms are categorized into internal and external mechanisms. During the process of privatization performance is expected to improve when government gives up control, because control and cash flow rights are transferred to managers who strive to build up profit and efficiency. Johnson and
Schleifer (2004) argue that without investor protection, privatization is not likely to succeed. Consequently we post-privatization performance will be higher in countries where laws protect shareholder rights and where an efficient legal system exists to enforce these laws.
CHAPTER IV: DISCUSSION

As noted in Chapter III, majority of registered companies in Rwanda are private limited companies, where majority controlling power is with individual shareholders. This is mostly because these private limited companies are family run businesses. The legal and regulatory framework has been strengthened by amendments to the Company Law to strengthen the corporate governance system. Rafael (2000) notes that the presence of a regulatory framework as well as an enforcement system plays a key role in investor protection however trying to protect minority shareholders might not work effectively in a case where the majority shareholders is the manager and this will instead leave the problem as exploitation of outsider shareholders by the institutional investors.

Johnston (2004) in his forward to the OECD notes that corporate governance is crucial both in the developing and the developed world. Economic growth and interaction of economies through globalization and advance in technologies has meant that global governance is now a concern in all parts of the business world. Even in individual economies global governance is critical as an impetus for growth, investment and sustainable growth.

However there are difficulties with enforcement and education of the basics of good corporate governance to the majority of the companies such as access to financial records, filing business returns, appointment of board members, director remuneration as well as holding of annual general meetings. The main institutions that's play a key role in maintaining good corporate governance are the commercial banks that have stringent rules for borrowers including audited financial reports, corporate structure, list of directors, and subject borrowers to greater scrutiny that makes them compliant with good corporate governance as a pre-requisite for accessing funds.

Iskander and Chamlou (1998), note that a healthy and competitive corporate sector is fundamental for sustained and shared growth. They compare the importance of public service delivery in the public sector (service delivery and administration) to corporate governance in the private sector. The purpose of corporate governance is not only to attract foreign investment, but also to strengthen the capital markets by encouraging the growth of local investors. The stability of local markets gives investors the confidence to provide their capital.
The enforcement of good corporate governance practices will always present a challenge unless willingly undertaken by the shareholders and management of the companies themselves or by external stakeholders like lenders, and regulators like the Registrar of Companies. There are a number of factors that affect the role of the Private Sector Federation and the Investment Promotion department from fully being able to implement and shape corporate governance in Rwanda. For this to change, we need to analyse the below factors;

Sabarnes Oxley Act was enacted as a response to corporate failure, with the aim of improving corporate governance and restoring investor confidence. The inaccessibility of information from most public and private companies greatly hinders the ability of any agency or shareholder to play a monitoring role. For this to be possible, companies must provide relevant information in a timely manner to all shareholders and stakeholders, especially financial records. As noted in Chapter III in the interview with the CEO of the Private Sector Federation, access to financial information was one of the big challenges, and although this challenge is being faced there is an additional challenge of verifying the information provided. The availability of timely and accurate information is crucial in helping investors make correct financial decisions in a timely manner, in order to maximize their potential returns. Therefore the timing and availability of accurate financial statements by companies in Rwanda needs to be addressed.

Bebchuck (1989) looks into how the capital market will continue to play a key role in the monitoring and guiding the implementation of good corporate governance particularly in companies that raise capital through shares and debentures. However in the case of Rwanda where the capital market is still very small, it will take time before it has matured enough to make a strong impact on corporate governance practices in the companies. This therefore means that the government through the Private Sector Federation and the Investment Promotion department has to work with the banking sector particularly commercial banks and development banks to ensure that through their lending activities they can also play a monitoring role in corporate governance. The Central Bank should create a policy that makes it easier for companies to access funds from banks, and at the same time banks increase their monitoring role particularly in terms of availability of financial statements, audits, director lists, self-lending activities which lead to increased transparency. The current legal framework for the banking sector was amended after the big failure of BCDI (Banque Commerciale de Developement et
d'Indistrie) in 2005 that was largely attributed to insider-lending, corruption, abuse of office, falsification of documents illegal awarding of loans to close family members of the then majority shareholder. At the time of the collapse of the bank, there were reportedly illegal loans of over RwF 800million (approximately $1,400,000) between the majority shareholder, his wife, sister and brother. This together with a string of bank failures in the neighbouring Uganda (on which the Rwandan economy is closely inter-linked to) where three banks closed between 1998 and 1999 meant tighter measures had to be imposed by the Central Bank in order to enhance the liquidity of banks and protect depositors. This however had an effect on the borrowing as restrictions were tightened and borrowers sought alternative sources of funding. High interest rates and unstable currency fluctuation also discourage companies from borrowing as cost of funding is high, and this leads to debt among borrowers, which in turn discourages commercial banks from lending. According to the CEO of the Private Sector Federation, as long as borrowing measures are restricted, companies will not approach banks for funding, and therefore banks will not be able to play a role in monitoring their governance practices.

As observed in Chapter 4 from the interview with the Senior Investment Officer at the Investment Promotion department, there is a notable weakness in the enforcement institutions in Rwanda, and the need to strengthen enforcement mechanisms in both formal and informal way is critical for corporate in Rwanda. The effectiveness of controls, especially the formal depends on the ability to enforce them. Informal mechanisms can be enforced by parties such as banks on the borrowers through cutting of funding unless specific requirements are met. Legal reform in Rwanda has also been achieved to a great extent most especially with the drive to increase foreign direct investment, and several radical reforms were taken as part of the World Bank “Doing Business Reform” report. In 2011, Rwanda was the most improved country in Africa, and second most improved overall and fourth easiest place to do business in Africa.

Strengthening of legal reforms can ensure effectiveness and ease with which good corporate practices can be applied in both formal and informal mechanisms. Informal mechanism would focus on strong advocacy through the Private Sector Federation and the use of lenders to implement good corporate governance, while formal mechanisms include the legal framework and monitoring by government agencies. Estrin and Prevezer (2010) in their research thesis argue that the relationship between informal and formal mechanisms depends on whether the
formal institutions are effective and how compatible the goals of agents in formal and informal institutions are. They further argue that in emerging and developing market economies, family ownership is the most prevalent mode, together with state ownership of some companies, and a few financial industrial groups. In these scenarios there are weak capital markets, legal and judicial infrastructure which make family ties highly significant, and the state can also play a role in corporate governance. Therefore in the case of Rwanda the role of the informal mechanisms such as commercial banks can be boosted by the strengthening of institutions like the Registrar of Companies, courts, or the revenue authority on which these companies rely.

Therefore, in order to make good corporate governance more effective and widespread by embracing more the roles that could be played by formal and informal mechanisms complementing each other strongly and devising mechanisms to ensure enforcement of good corporate governance as well as improving shareholder activism. Once all these obstacles are addressed then a meaningful corporate governance system will be achieved.

In answering the research question “What is the importance and need for corporate governance codes for institutional investors and the capital market in Rwanda?”

4.1 Importance of Corporate Governance in emerging economies:

With the convergence of global economies towards a market-based system, modern companies are now at the centre of economic growth. It is therefore important that companies are managed in a way that is beneficial and acceptable to society, rather than in the interests of private individuals. Corporate governance is arranged such that the interests of all stakeholders in the firm.

The importance of corporate governance became clear in the 2000’s after the corporate meltdowns in the United States that led to massive job losses, billions of dollars in losses to shareholders, record bankruptcy filings. (Metzger, 2004) The Asian Financial Crisis of 1997-98 was attributed to poor corporate governance, and closer to Rwanda the bank collapses in Uganda between 1997 and 1999 were all attributed to poor corporate governance. (Sapte, 2002)

Globalization has led to more interaction between economies and companies in different countries, and this has brought the aspect of corporate governance into focus again particularly in
developing countries. Global trade has also necessitated that companies operations are more capital intensive that they were before and individual’s resources are not able to maintain the capital demands, and commercial bank lending requirements mean that not all companies are able to access their funds. Companies have therefore had to resort to capital markets, and this mechanism means that investors do not participate in the day-to-day management of these companies. Companies therefore operate far beyond their borders and this has led to economic growth, and the phenomenon known as globalization.

According to Mr Namara, “Over the last 15 years as we joined the East African Community and opened our markets to the outside world, a number of companies have come to Rwanda. In order for our companies to remain competitive and in order for them to grow and received funding (both external and internal), they have to adopt good corporate governance practices. No two ways about that! They must adopt good practices or perish in this competitive world!!”

Until recently most emerging economies had no knowledge and need of corporate governance because of heavy reliance on legal and regulatory framework protected the investors, and imposed discipline on company management. However following corporate scandals in the United States, Japan, and closer in Kenya there is need to rebuild investor’s confidence especially in companies where they do not participate in the day-to-day affairs. Company management are therefore now facing rigorous measures that are aimed at improved transparency and accountability. Examples of India and China that are emerging economies and have seen strong economic growth but still have a problem of low investor confidence due to corruption scandals, weak legal controls, and lack of transparency have a negative impact. As we can note, corporate governance is therefore necessary for both the emerging and developed economies if sustainable growth, development and investment are to be obtained. In the view of Mr Namara “An effective corporate governance regime is a critical weapon in building confidence in markets, and attracting investment which is what the economy needs. But not only a code but also we need to see individual ethics, corporate ethics, internal control mechanisms, external control mechanisms and laws & regulations at work. With this we will have a perfect scenario for good corporate governance.”
There is a notable link between good corporate governance practices and economic growth in countries. Good corporate governance facilitates the performance of companies (which are the engine of growth of the economy) by creating an environment where returns are maximized, manager’s utility maximized, high returns on investment, and high production growth. With a corporate governance code in place, investors and stakeholders interests will be protected; there will be limited misappropriation of company funds and assets, improved manager performance, increased transparency and accountability.

Lastly the importance of corporate governance is that it creates a foundation for a sustainable growth of a corporate sector in Rwanda. Once companies begin to realize the importance and importance of good governance in terms of attracting investment and growth (and turnover, increased employment, increased sales) and provide a competitive advantage over well governed companies over those without. In Mr Namara’s view “at the start there is always some resistance to the stringent measures being imposed, but with time the owners of these companies realize the benefits and the long-term use of these measures we put in place.”
CHAPTER VI: CONCLUSION AND RECOMMENDATIONS

To answer the question “does corporate governance really matter?” we can compare the importance of corporate governance to that of the governance of countries, as stated by former World Bank President James Wolfensohn. The benefit of good corporate practices to companies that practice it include reduced agency costs, reduced inefficiency arising from conflicts between owners and management and these benefits lead companies to grow and become competitive. According to the OECD (1999) good governance is important in building investor confidence in companies (and the capital market in general), encourage long-term financing, and encourage capital inflows through Foreign Direct Investments. It is acknowledged by the government of Rwanda that one of the most effective ways in which to develop the young capital market is through effectively implementing good corporate governance practices.

Corporate governance is beneficial when investing in emerging markets and companies with good corporate governance have higher financial returns, better performance, better growth prospects, lower borrowing costs and higher value as compared to those with low corporate governance that are considered as high risk investments.

Ho (2003) states that even though good corporate governance does not automatically mean that the firm will perform well, it is proof that bad corporate governance is an early indicator of trouble to come. Looking at examples of the companies that collapsed in the United States like Enron, Xerox, WorldCom, Lehman Brothers, there is strong evidence that these collapses were due to bad governance. These incidents prove that despite the strong legal and regulatory framework in place there are some shortcomings and these affected the financial market and reduced investors’ confidence in the market.

In Rwanda, the issues and need for corporate governance have been propelled by the corporate scandals in neighbouring countries in the East African Community particularly in Kenya and Uganda, as well as globally. The biggest culprit of these failures was weak corporate governance. In order for Rwanda to have an efficient capital market, improve economic growth and efficiency, have attractive markets, enhance investor confidence and maintain financial stability, it is very critical to have a good corporate governance regime. As noted from the interviews in chapter IV of this research, the government of Rwanda has high priority on
corporate governance particularly in the private sector in terms of protecting minority shareholders’ interests. The government has made considerable steps in making radical reforms to legislation, guidelines and empowering enforcement agencies. Despite a few constraints some progress has been made in laying a solid foundation for corporate governance in Rwanda.

Though Rwanda has a lot of work to do in regards to corporate governance, it needs to rely not only on the legal and regulatory framework to enhance good governance. Borrowing from the experiences of other countries where stringent regulations have not curbed bad governance it is important to advocate and promote the improvement of internal control mechanisms, ethics of company management and staff, and promoting ethical behaviour from top to bottom.

Good corporate governance can only be achieved with all players, shareholders and stakeholders working together towards achieving the objective of creating the best value for the company. One of the objectives of this research is to propose a draft corporate governance code that can be adopted by companies in Rwanda and enable it to grow as a world-class financial and business centre.

6.1 Guiding Principles of good Corporate Governance:

How can Rwanda develop a standard corporate governance code as well as ensure ethical behaviour by institutional investors and management? This research question is related to the last part of this thesis, which is proposing corporate governance codes which can be adopted in Rwanda. As with many other emerging countries, Rwanda will face many challenges as many business register in the midst of economic growth. It is essential that good governance is practiced as a source of investor confidence and attracting capital. This can only be achieved through guaranteeing investor protection, sound board practices, transparency and disclosure, which are applicable to both domestic and international investors. To do this, Rwanda as a country needs to look at guiding principles of good corporate governance that have been applied successfully in other countries and use these to guide players in the financial market and companies to adopt these good practices.

As a guiding sample for developing a corporate governance code, we shall look at the corporate governance code of Kenya that is similar to Rwanda in terms of being an emerging economy, but
with a more advanced capital market, a larger presence of institutional investors, and a bigger number of public limited and private limited companies, as well as referring to OECD principles of good governance (2004). Therefore it is expected that Rwanda will take the same path taken by Kenya to get to where it is. Among the key elements that can be used in a Rwanda corporate governance codes are;

1. Authority and duties of shareholders.
2. The roles and functions of the board of directors.
4. Board appointment criteria.
5. Director’s remuneration.
6. Directors’ declaration of interests.
7. Access to information by directors.
8. Directors’ training and development.
10. Duties of the auditors.
11. Role of the audit committee.
12. Rights of the shareholders.
13. Responsibility to other stakeholders.

1. Authority and duties of shareholders; shareholders are expected to use their authority, to ensure that only competent and reliable people are appointed to the board of directors, that the board is constantly held accountable and responsible for the efficient and effective running of the company, and that the board works according to the mandate of the company.

The leadership of the company (the board of directors) shall exercise leadership, wise judgement and integrity in directing the company towards prosperity.

2. The roles and functions of the board; the board of directors (limited by the articles of association) shall use their leadership and sound judgement to direct the company towards prosperity, ensure that board appointments add value to the decision making process, determine
the company’s value and purpose and procedures are in place to protect the company’s assets, evaluate the implementation of strategies, policies, performance and business plans, ensure the company complies with the law and regulations and practices business ethics, ensure proper communication between shareholders and stakeholders, provide accountability to shareholders and act in their best interest, determining policies on how to relate to internal and external stakeholders, ensure processes and procedures are in place to have an effective internal control system, appointment of senior management and succession plan for senior management, ensure adequate and up-to date systems and technology is used in order for the company to remain competitive, identify and monitor company risk factors, and carry out annual analysis to ensure company survival in the short-run and long-term.

3. The composition of the board shall include both executive and non-executive directors so that no individual or group can dominate the decision making process. At least one-third of the members must be non-executive directors. As per Rwandan Company Act, at least one director should be resident in Rwanda. As a rule there should be clear distinction between the roles of the Board Chairman, and that of Chief Executive. This is to ensure balance of power, and no individual has unfettered decision making powers.

4. Appointments to the board will be carried out in a formal and transparent procedure. The composition will be reviewed once every two years to ensure continued performance based membership. Shareholders will approve renewal on recommendation of the board. Board committees shall be created from among the board members to include an audit committee and Human Resource committee among others, to be headed by non-executive directors.

5. Directors remuneration; the board will be given adequate compensation for their time and where agreed by the general assembly an appropriate bonus can be given to the board members. In order to avoid a conflict of interest an independent remunerations committee will decide the remuneration, and report to shareholders annually.

6. Declaration of interest by directors; all directors shall regularly in good faith disclose to the board any business or other interests likely to create potential conflict of interest whether in
business, trade in other businesses, shareholding in other companies, gifts received or extended to other companies.

7. **Supply of information to directors;** to enable board members to perform effectively they need to have access to relevant, accurate and timely information. There should be a formal procedure for directors to take professional advice in regards to matters relating to their functions, and it is the right of the director to demand and obtain any information s/he deems critical to the performance of his duties as a director.

8. **Directors training and development;** the weighty duties placed upon directors and the level of commitment and decisions expected from them necessitate that the company prepares those it places in those positions. It is recommended that directors receive formal training on their roles, duties, responsibilities, obligations, board practices and procedures upon their first appointment.

9. **Accounts: Audit and Disclosure;** it is the responsibility of directors with others to cause to ensure that there are properly maintained and accurate books of accounts are kept reflecting all amounts of money spent and received by the company and the matter in which receipt and expenditure takes place, all sales and purchases, all assets and liabilities, so as to get with all accuracy possible the financial position of the company at any given time at to show at the annual general meeting the account statements, balance sheet reflecting a true and fair value of the profit and loss of the company.

10. **Duties of the auditors;** the board of directors should ensure that qualified, reliable and independent auditors are appointed. The auditors are expected to provide an independent opinion to those with interest in the company. The board should facilitate the auditors in doing their work; ensure there is independence of the auditors from the board or management.

11. **The role of the audit committee;** an audit committee is responsible for a thorough and detailed review of audit matters which enables the non-executive directors to play a positive role they are particularly fitted for. The audit committee shall review the results of the audit, the scope, the effectiveness, independence and objectivity of the auditors.
12. **Rights of the shareholders:** the shareholders rights shall be recognized, respected and respected. These include securing methods of ownership registration, buying or transferring shares, obtaining relevant information on a timely and regular basis, participating in voting during the annual general meeting, electing board members, and sharing in profits of the company. The board should ensure equitable treatment of all shareholders including minority and foreign shareholders.

13. **Responsibility to other stakeholders:** the board should recognize and ensure the rights of other stakeholders and ensure co-operation between the company and the stakeholders in creating jobs, wealth, and sustainability.

14. **Corporate social responsibility:** the board has the responsibility of monitoring the social responsibility of the company and formulate policies in line with the companies legitimate interests and good business practices. These include fair and equitable employment policies, protection of the natural environment, sensitivity to gender concerns, promote and protect the rights of children, and promote the rights and participation of the host community.

**6.2: Recommendations:**

Given that corporate governance can influence the performance of both public and private companies, it is important that the governments adopts and strengthens the corporate governance principles especially in regards to financial disclosure and transparency. This will build a bond of trust with stakeholders including customers, society, and the government among others. Some of these stakeholders especially the consumers will eventually invest their funds in these companies for example if they are listed on the stock exchange locally or internationally.

Companies operating in Rwanda today should focus on proper governance practices and principles not only to benefit from the improved financial performance but also for a better public image (through CSR) and to be recognized by the society in which it operates as a socially receptive organization, and this will support its operations and survival.
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*Interview with:*

1) Hannington NAMARA, Chief Executive Officer, Rwanda Private Sector Federation. (8\textsuperscript{th} May 2012).

2) Peace KALIISA, Senior Investment Promotion Officer, Rwanda Development Board. (9\textsuperscript{th} May 2012).

**APPENDIX 1: Interview Protocols**

a) *Interview with Chief Executive Officer of Private Sector Federation, Rwanda.*

*Background information on Interviewee:*

1) Date:
2) Name:

3) Job Title:

4) What are your primary responsibilities:

5) How long have you held this job?

**Questions related to corporate governance and PSF**

6) What is the role of the Private Sector Federation?

7) What are the benefits of a corporate governance code to an emerging economy like Rwanda’s?

8) How do you ensure that small shareholders are not jeopardized by institutional investors in their quest for self-interest?

9) Does the PSF play any role with the Capital Markets Authority in ensuring transparency and acceptable operating standards?

10) Are investors more interested in companies with corporate governance procedure in place or those without, where they are able to influence decision making?

11) Briefly, what led to the collapse of the commercial bank BCDI, and what governance measures are in place to ensure the same does not happen again?

12) Has this had an effect on other businesses?
13) From the collapse of several companies around the world due to management fraud and poor governance, are there any lessons learnt for Rwandan companies? Have measures been put in place to ensure such collapses do not occur in Rwanda?

14) What are the factors that limit the ability of PSF to implement good governance codes? Has privatization played a role in the development of corporate governance in Rwanda?

15) On which institutions do you rely to enforce your obligations?

16) How efficient are those institutions?

17) Do you think the monitoring mechanisms have a long term impact on the management of the companies?

18) Any constraints faced?

19) With the growth of the capital market and the presence of institutional investors, is it necessary to have a corporate governance code in place?

Thank you!

b) **Interview with Senior Investment Officer at Rwanda Development Board.**

**Background information on Interviewee:**

1) Date:
2) Name:

3) Job Title:

4) What are your primary responsibilities:

5) How long have you held this job?

Questions related to investment procedures.

6) Roughly what percentage of investments in Rwanda would constitute institutional investors?

7) What is the government’s policy in regards to institutional investors?

8) How do you monitor institutional investors to ensure they don’t serve in their self-interest and jeopardize small shareholders?

9) Does the nature and degree of monitoring vary with size and nature of the investor (foreign or local)? Any problems encountered in monitoring and enforcing the obligations you impose on institutional investors and public companies?

10) Does the presence of institutional investors have a positive or negative impact on the management of the companies?

11) Does the absence of a corporate governance code discourage foreign companies from listing on the capital market?

12) How will an effective corporate governance code affect the capital market?

13) Does corporate governance act as a key feature in attracting foreign direct investment to Rwanda?

14) On which institutions do you rely to enforce your obligations?

15) How efficient are those institutions?
16) Have there been cases of clients / shareholders losing their investments due to weak protection structure (for example collapse of commercial bank)?

17) Do you think the monitoring mechanisms have a long term impact on the management of the companies?

18) Any constraints faced?

19) Any other comments?

20) With the growth of the capital market and the presence of institutional investors, is it necessary to have a corporate governance code in place?

Thank you!