

# THE CORPORATE GOVERNANCE RATING SYSTEM

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**January 29, 2014**

# The Issues

**8 Factors  
Contributing to  
Crash of the  
Equities Market  
2008-2009**

1. Macro-economic instability caused by large and sudden capital inflows
2. Major failures in corporate governance at banks
3. Lack of investor and consumer sophistication
4. Inadequate disclosure and transparency about financial position of banks
5. Critical gaps in regulatory framework and regulations
6. Uneven supervision and enforcement
7. Unstructured governance & management processes at the CBN/weaknesses within the CBN
8. Weaknesses in the business environment

Sanusi, L. S. (2010), The Nigerian Banking Industry – what went wrong and the way forward, Speech at the Annual Convocation Ceremony of Bayero University, Kano, 26 February 2010, <http://www.bis.org/review/r100419c.pdf>

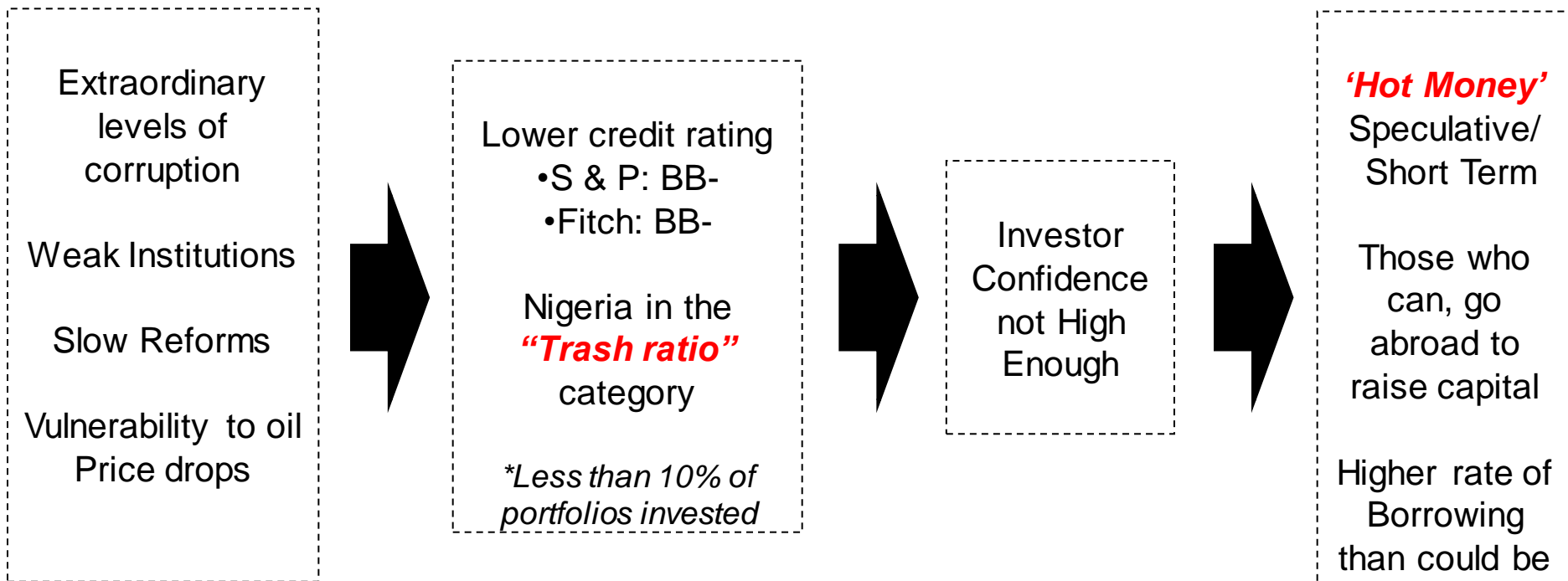
## FPI vs Domestic Investment

YEAR	FPI Flow ('Billion)	Transactions on the Exchange (N' Billion)	FPI (%)	Domestic Investors (%)
2007	615.63	4,171.63	14.8	85.2
2008	787.4	4,758.27	16.5	83.5
2009	424.6	1,371.43	31	69
2010	577.3	1,598.93	36.1	63.9
2011	847.9	1,269.83	66.8	33.2
2012	808.4	1,317.00	61.4	38.6
March, 2013	217.56	510.10	42.7	57.3
N.B. Stock Market Transactions is defined to include Purchases and Sales				

Source: NSE

- Domestic investors' stake which dropped from 85.2% in 2007 to 33.2% in 2011 has continued to increase as they recorded a 38.6% stake in 2012 and 57.3% so far as at March 2013.
- Of Nigeria's \$48bn in reserve, about \$18bn is due to foreign investors. Nigeria is happy FPI is increasing but does this give a **False sense of security?**

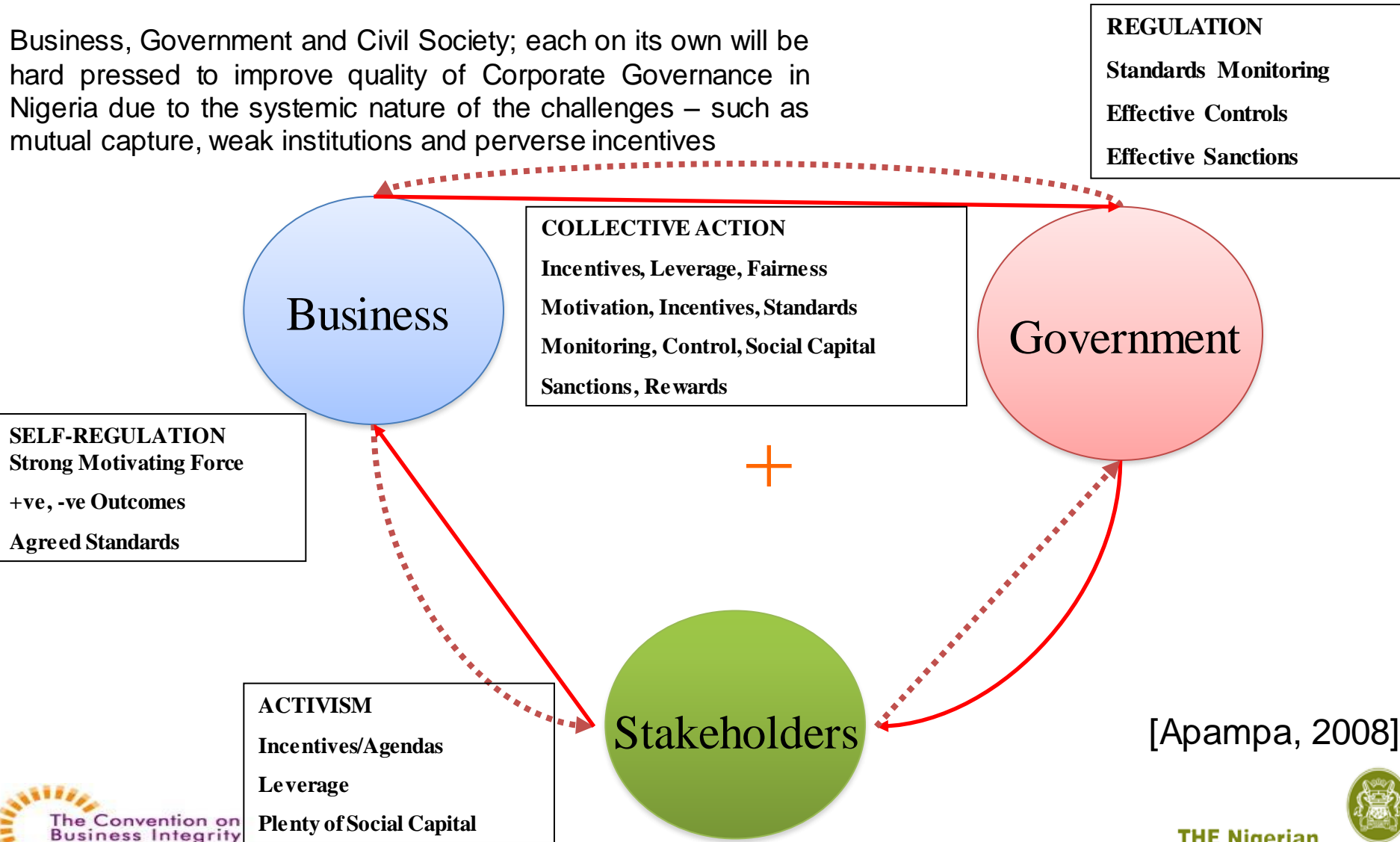
# Nigeria's Sovereign Credit Rating



**Expensive for Nigeria too - some analysts suggest for every \$1 that comes into Nigeria, \$1.4 leaves with the investor**

# Locus Of Control

Business, Government and Civil Society; each on its own will be hard pressed to improve quality of Corporate Governance in Nigeria due to the systemic nature of the challenges – such as mutual capture, weak institutions and perverse incentives



[Apampa, 2008]

## What we need?



## A Control Mechanism!

- *We need to find an appropriate corporate governance response to what was a systemic failure*
- *A response which corrects for the failure of self-regulation by corporate bodies; failure of government regulation; and failure of stakeholder activism whilst strengthening the overall system at the same time*

## The SOLUTION – A Fix for Nigeria



A **robust corporate governance system** for Nigeria that will incorporate a number of other elements to ensure support for the objectives of regulation such as:

- *Standards setting,*
- *Information-gathering and*
- *Behaviour modification*

## Recommendation

- **A robust Corporate Governance System that would comprise of 4 dimensions:**
  - A Corporate Integrity Dimension
  - A Dimension for compliance with NSE Rules & General governance rules (SEC Code, CAMA with industry-specific rules added as relevant)
  - A Dimension reflecting Certification/Accreditation of Directors & Specialist Committees such as Audit, Ethics, Risk and so on and finally
  - A Dimension reflecting the confirmation of expert stakeholders of a company's integrity



# Why the CGRS is necessary

		GOVERNANCE ARRANGEMENTS IN ZONE OF OPERATIONS	
		Strong	Weak
STRENGTH OF HOME COUNTRY COMPLIANCE REQUIREMENTS	Strong	<b>COMPLIANCE EXPECTATION</b> Participate Where there Could be Competitive Disadvantage	<b>REPUTATION RISK EXPECTATION</b> Participate to Defend Brand & Evade Sanctions at Home
	Weak	<b>MARKET RISK EXPECTATION</b> Participate to Evade Market Sanctions & Position Brand	<b>IMPUNITY RISK EXPECTATION</b> Participate Where there could be Competitive Advantage

## Other Expected Impacts

### Competitive Advantage

Improved investor confidence

Higher Valuation of the firm



Access to cheaper funds

Longer term investments



Enhanced liquidity and tradability

Better operational performance

Improved financial performance

## Governor of the Bank of Thailand

- Reacting to the crash of the Asian Tigers:

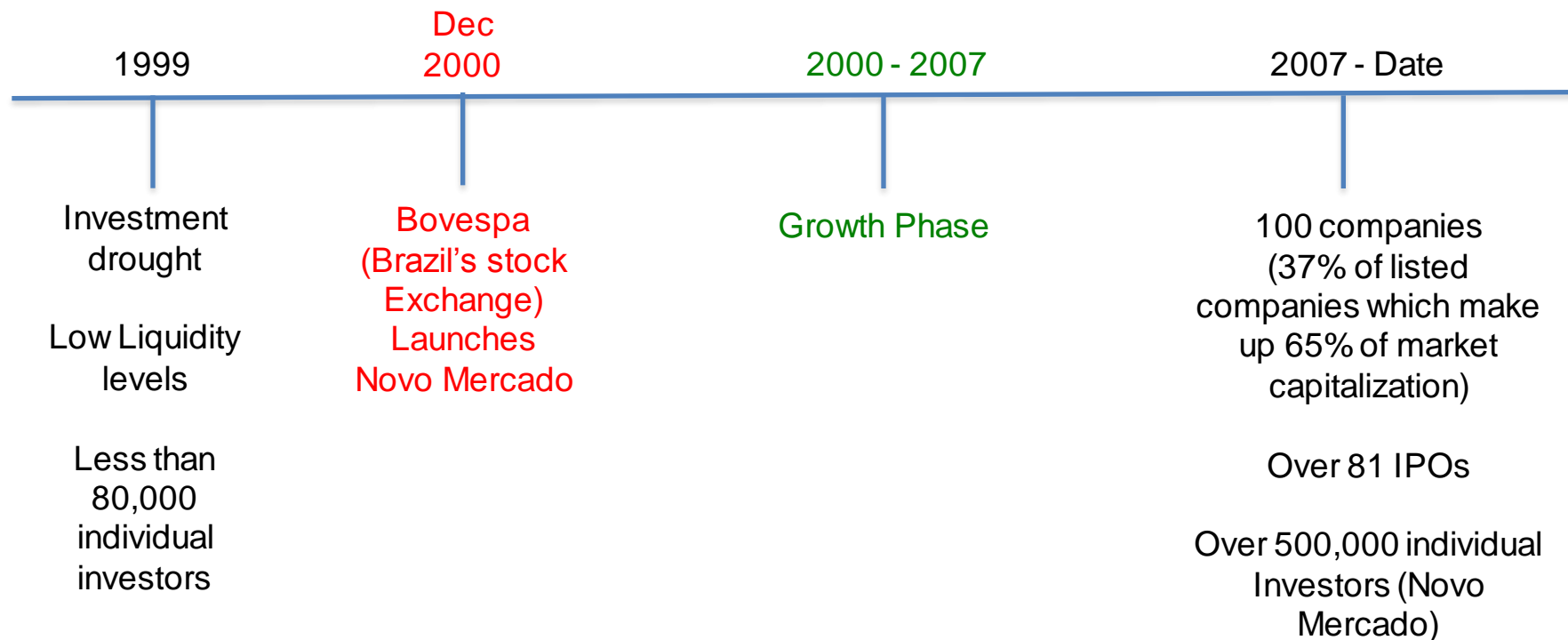
***“Even strong economies, lacking transparent control, responsible corporate boards, and shareholder rights can collapse quite quickly as investors confidence collapse”***

M.R. Chatu Mongol Sonakul (1999)

## Do Right, Do Well!!

- 'The investment regime and the environment for business ranked second in order of importance among factors determining foreign investment location'. **IMF-Capital Markets Consultative Group**
- **A study by Korean and US researchers** finds that a well-governed firm in Korea traded at a **premium of 160 percent** to poorly governed firms
- **An ABN/AMRO study** demonstrates that Brazil-based firms with the best corporate governance **ratings garnered 2004 P/E ratios that were 20% higher** than firms with the worst governance ratings
- **A study of Russian firms** shows that a worst-to-best improvement in corporate governance predicted **a huge 700-fold (70,000%) increase in firm value**
- **A Harvard/Wharton study** shows that if an investor bought shares in US firms with the strongest shareholder rights, and sold shares in the ones with the weakest shareholder rights, that investor would have earned **abnormal returns of 8.5 percent** per year

## An Example: The Novo Mercado Story



***BOVESPA decided to establish the Novo Mercado Index that was available to companies that commit to adopting higher standards of corporate governance with the hope that reducing investor perceptions of risk would have a positive effect on share values and liquidity.***



# The Novo Mercado Story

- The results were **phenomenal!**  
*Foreign investors were attracted, and companies issued more secondary offerings.*
- Stopped Brazilian companies from relocating to more shareholder friendly jurisdictions and global regulatory competition which saved the economy.
- The Novo Mercado companies currently outperform those on the BOVESPA index.
- In October 2007, the stock exchange went public; its market capitalization became the largest among all emerging market countries.

Brazil - IGC vs IBOVESPA



**Evidence shows that Novo Mercado is one of the drivers for increased demand in Brazilian equity**

## Brazil Weathered the financial crisis of 2008-2009

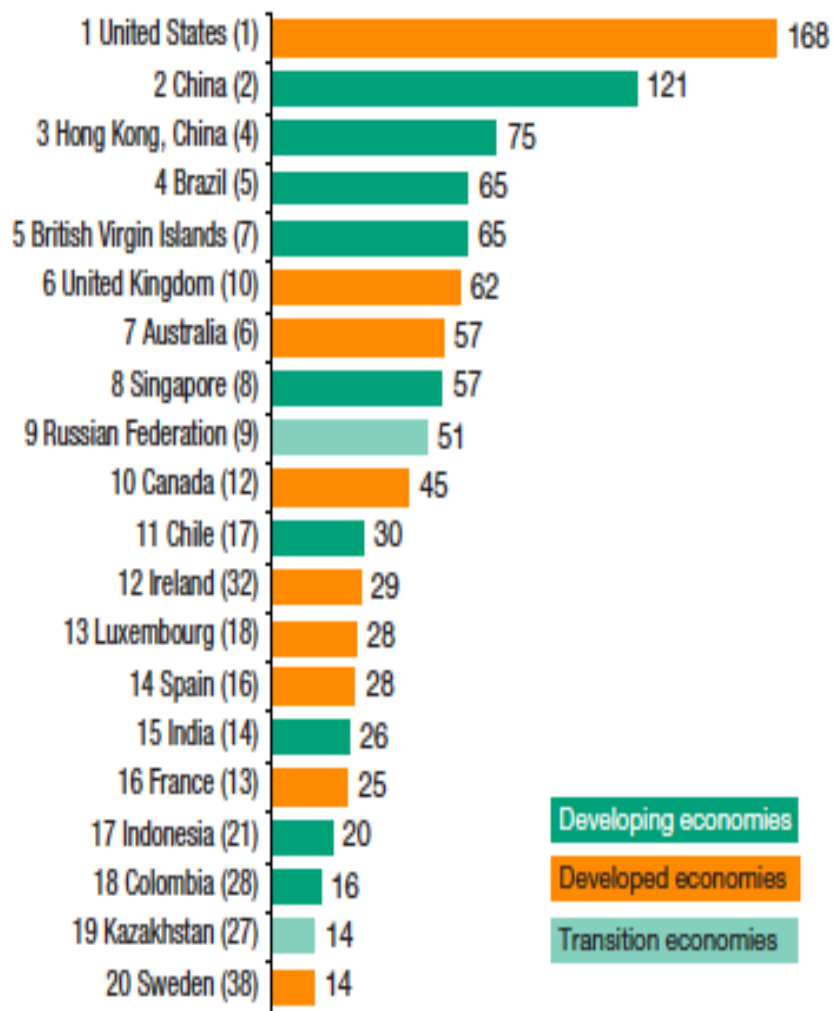
*‘Investors needed a safe harbor – and that’s precisely what Brazil and Novo Mercado offered them,’*

Ricardo Florence, President of IBRI (Brazilian Investor Relations Institute)

*‘If it weren’t for our higher governance standards, it would have been much more difficult to convince investors and financial institutions that the company was on the right path to get out of the crisis stronger than it entered. In hard times, credibility is crucial’.*

Adriana FernandesLana, IR manager at Magnesit

# Brazil: Current Picture



- Brazil is currently ranked 4<sup>th</sup> in terms of FDI Inflows
- Rated BBB on both S&P and Fitch

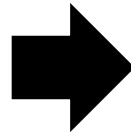
Source: UNCTAD FDI Prospects, The Nigerian

STOCK EXCHANGE

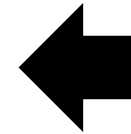




## The NSE and CBI have partnered to develop the CGRS



**Corporate  
Governance  
Rating System**



Established in 1997 to empower people, their transactions, systems & Institutions against corruption.

It is hoped that in time it will reposition the idea that Nigerian businesses are fraudulent and instead foster international relationships that can lead to meaningful exchange.



**Independent  
International Observers**

Research Interest in what Sanctions & Incentives to Apply to improve Business anti-corruption Compliance

Vision to become the gateway to African Markets

## The CGRS is also integral to the Premium Board & CGRS Index



2015



One of three  
requirements for listing  
on the Premium Board  
*(to be launched by the  
NSE this year)*



2014



# THE CGRS RATIONALE & METHODOLOGY

## Our Working Definition of Corporate Governance

- The OECD Principles of Corporate Governance states:

***"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the **objectives** of the company are set, and **the means** of attaining those objectives and **monitoring performance** are determined."***

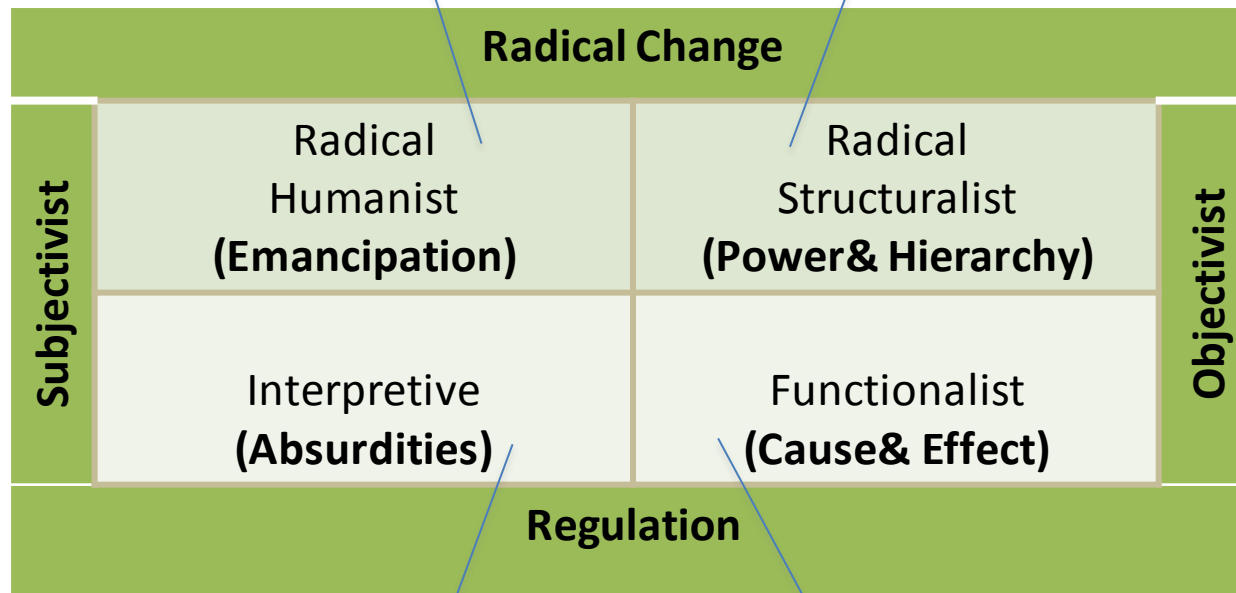
## The Starting Point

- We asked questions regarding what **constitutes acceptable knowledge pursuits in Corporate Governance** in Nigeria & agreed a Corporate Governance Index would be worthwhile.
- We addressed questions regarding the **nature of challenges of corporate governance** in Nigeria. For example:
  - How does the world we are trying to describe operate?
  - What should constitute acceptable data?
- Finally we examined **our values and value judgments** to ensure we are fully aware of their potential impact on the study – for instance the need for the issue of corruption to be adequately covered.

## Four perspectives

Assessment of who is a “good” company and who is not “good” to name & shame

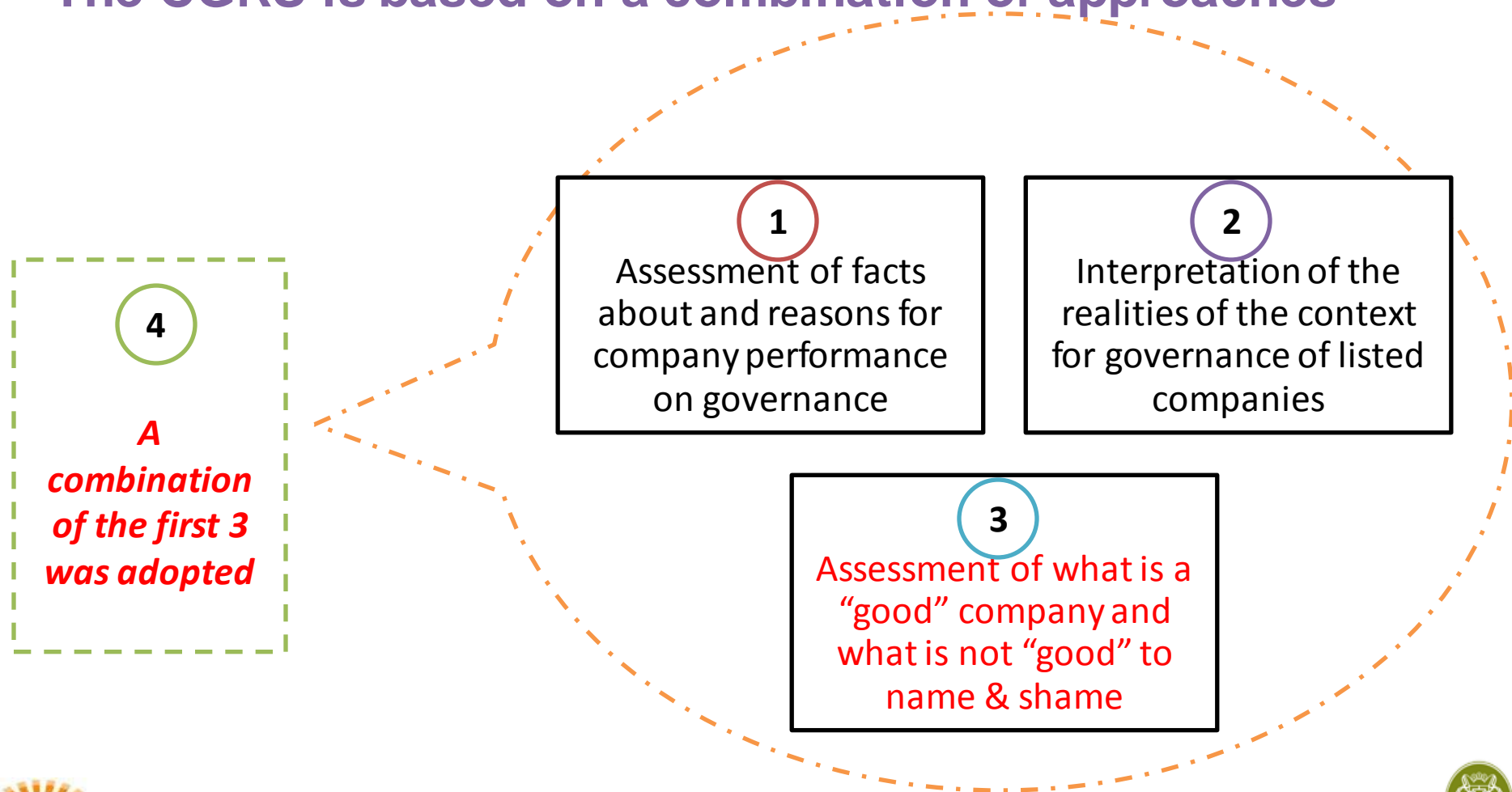
Assessment of relationship between mgt, board shareholders and other stakeholders



Interpretation of the realities of the governance of listed companies

Assessment of facts about and reasons for Company performance on governance

## The CGRS is based on a combination of approaches



# CGRS Components



## CORPORATE INTEGRITY (40%)

- NSE Rules & Listings Regulations
- SEC Code of Corporate Governance
- Ethics & Compliance Anti-Corruption Programme
- Track Record
- Company Reputation

## FIDUCIARY AWARENESS (10%)

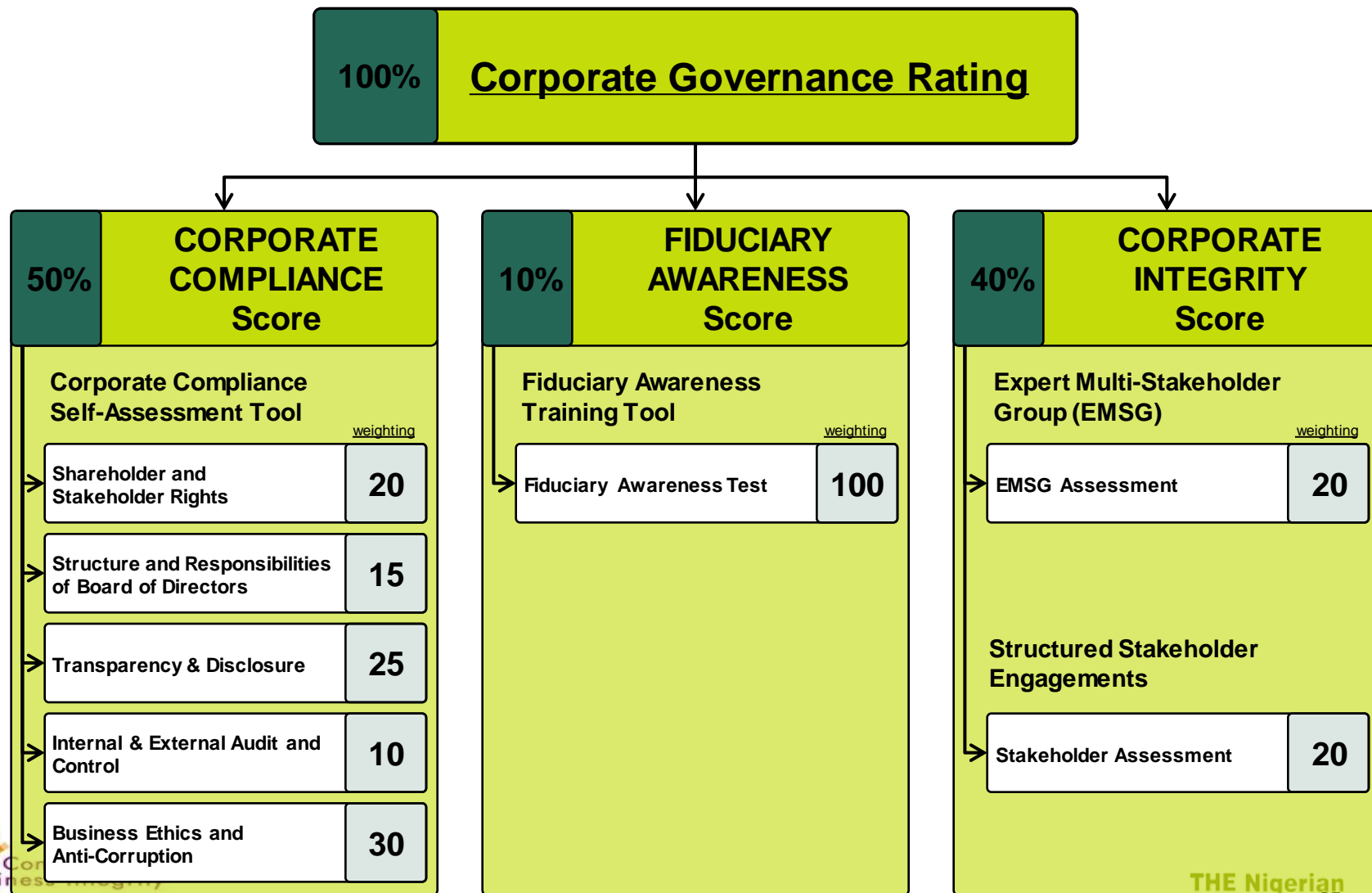
- Percentage of directors certified as possessing minimum understanding of their fiduciary responsibilities
- Certified as possessing minimum understanding of roles & responsibilities on specialist committees

## CORPORATE COMPLIANCE (50%)

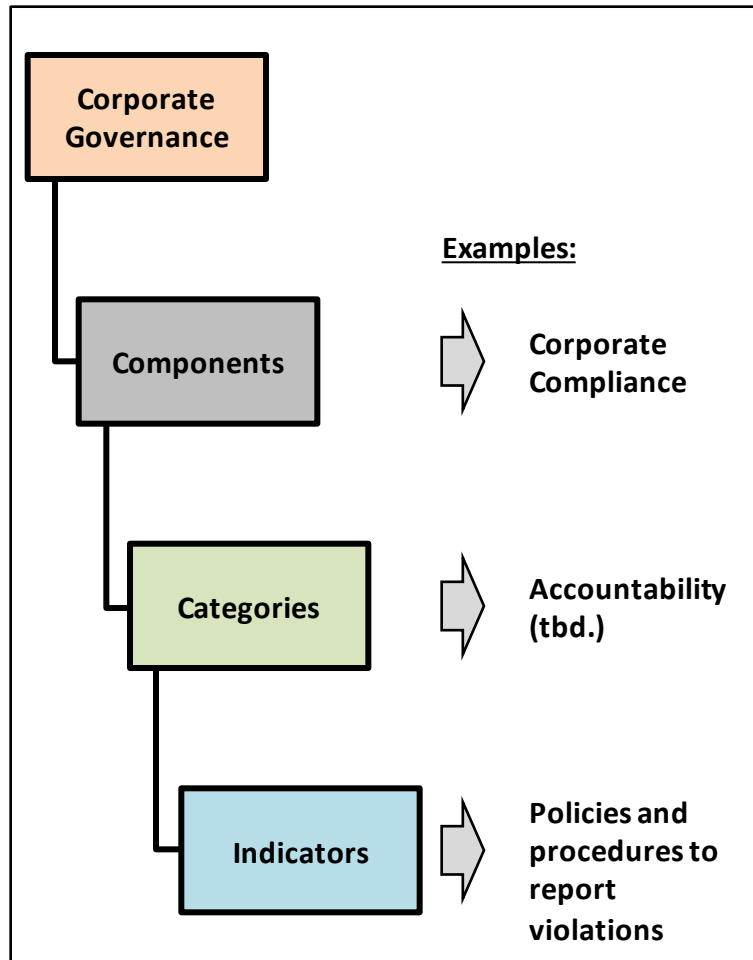
- NSE Rules & Listings Regulations
- SEC Code of Corporate Governance
- Ethics & Compliance Anti-Corruption Programme
- *Bonafides* Established
- Track Record



# Overall Scoring System



## The Self-Assessment Tool is based on..



- The **total score for 'Corporate Compliance'** (max. 50%) will be based on:

- **Input:** Self-assessments
- **Provider:** Companies
- **Hierarchy level:** Indicator

*Companies need to **score 35% or more of total score** to move on to the next level.*

# The Self Assessment Tool

*Companies will be responsible for completion of the Self Assessment because they are in the best positions to report on their policies and procedures*

## ▪One major risk

- *Companies may self-assess better than they are in reality*

## ▪Risk mitigation strategies

- *Self-assessment of companies is made public as a **Dashboard** on the CGRS website ([www.cgrsng.com](http://www.cgrsng.com)) from where users can drill down into forms and documents*
- *Random reviews of companies by Cbi*
- *Relevant sanctions in case of overstatements (e.g. impact on Corporate Integrity score)*

# Activities to reduce the burden of companies to provide data through self-assessments

## ■ The Self Assessment Tool

- *IT-based solution for provision of data*
- *Provision of indicators (and descriptors) and a clear and comprehensive Scoring Manual to companies*
- *Bulk of the effort is done once, at the start and thereafter only updates required*

# The Self Assessment Tool - DASHBOARD



Company Name:

Completion Date:

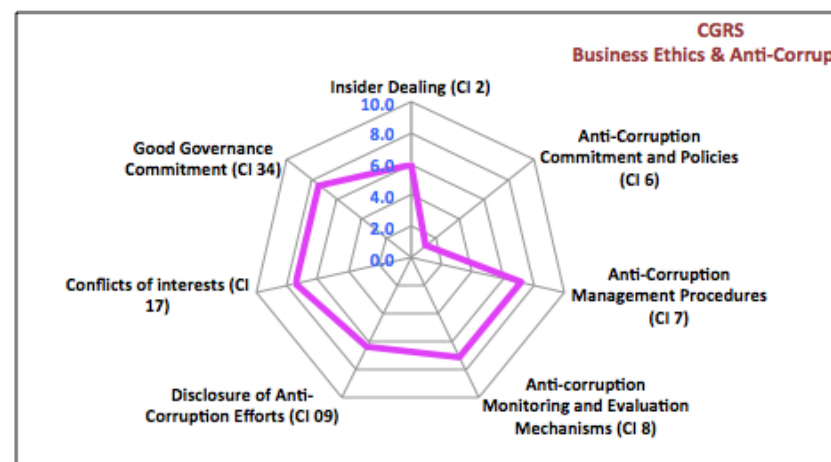
Overall Dashboard	Ave. Score	% Score	Weighting	Weighted Score
Business Ethics & Anti-Corruption	6.1	61.1	30.00%	18.3
Internal & External Audit and Control	7.2	71.8	10.00%	7.2
Shareholder & Stakeholder Rights	6.9	68.9	20.00%	13.8
Board Structure & Responsibilities	7.5	74.6	15.00%	11.2
Transparency & Disclosure	6.7	67.0	25.00%	16.8
<b>WEIGHTED TOTAL OF CORPORATE COMPLIANCE SCORE</b>				<b>67.2</b>

CI Indicative Key & Scoring Ranges	
Weak	<= 3.2
Moderate	3.21 - 5.16
Adequate	5.17 - 7.15
Satisfactory	>= 7.16

Completion Count

Total Indicators	36
Completed	36

Business Ethics & Anti-Corruption	Max. Score Available (Points)	Total Score (Points)
Insider Dealing (CI 2)	10	6.0
Anti-Corruption Commitment and Policies (CI 6)	10	1.2
Anti-Corruption Management Procedures (CI 7)	10	7.2
Anti-corruption Monitoring and Evaluation Mechanisms (CI 8)	10	7.1
Disclosure of Anti-Corruption Efforts (CI 09)	10	6.4
Conflicts of interests (CI 17)	10	7.5
Good Governance Commitment (CI 34)	10	7.5
<b>VERALL</b>	<b>10</b>	<b>6.1</b>



# Fiduciary Awareness Certification

**The Certification is based on the following modules....**

1. Background and Rationale of the Fiduciary Duty
2. Business Ethics & Anti-Corruption
3. Internal & External Audit & Control
4. Shareholder & Stakeholder Rights
5. Board Structure & Responsibilities
6. Transparency & Disclosure

***An E- Learning based Fiduciary Awareness Course has been developed in partnership with Phillips Consulting.***

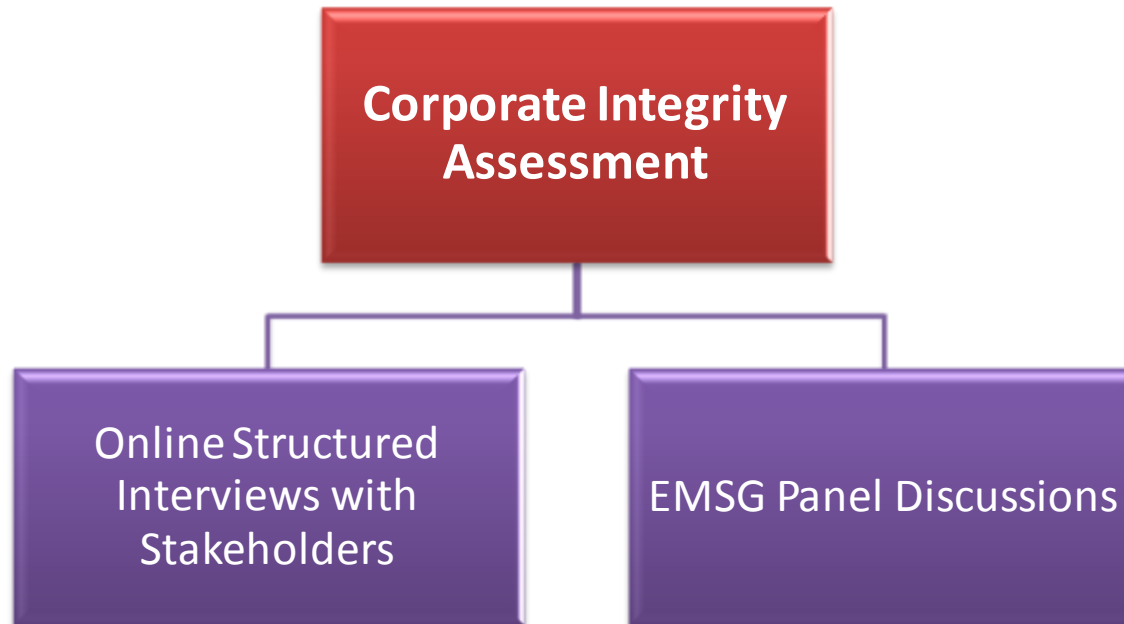
# The Fiduciary Awareness Certification

The Companies will send a current list of their Directors that will be compared against list of those that have been Certified on Fiduciary Awareness to the Secretariat



*All Directors should have this certification for maximum score otherwise score will be pro rata the number of certified directors*

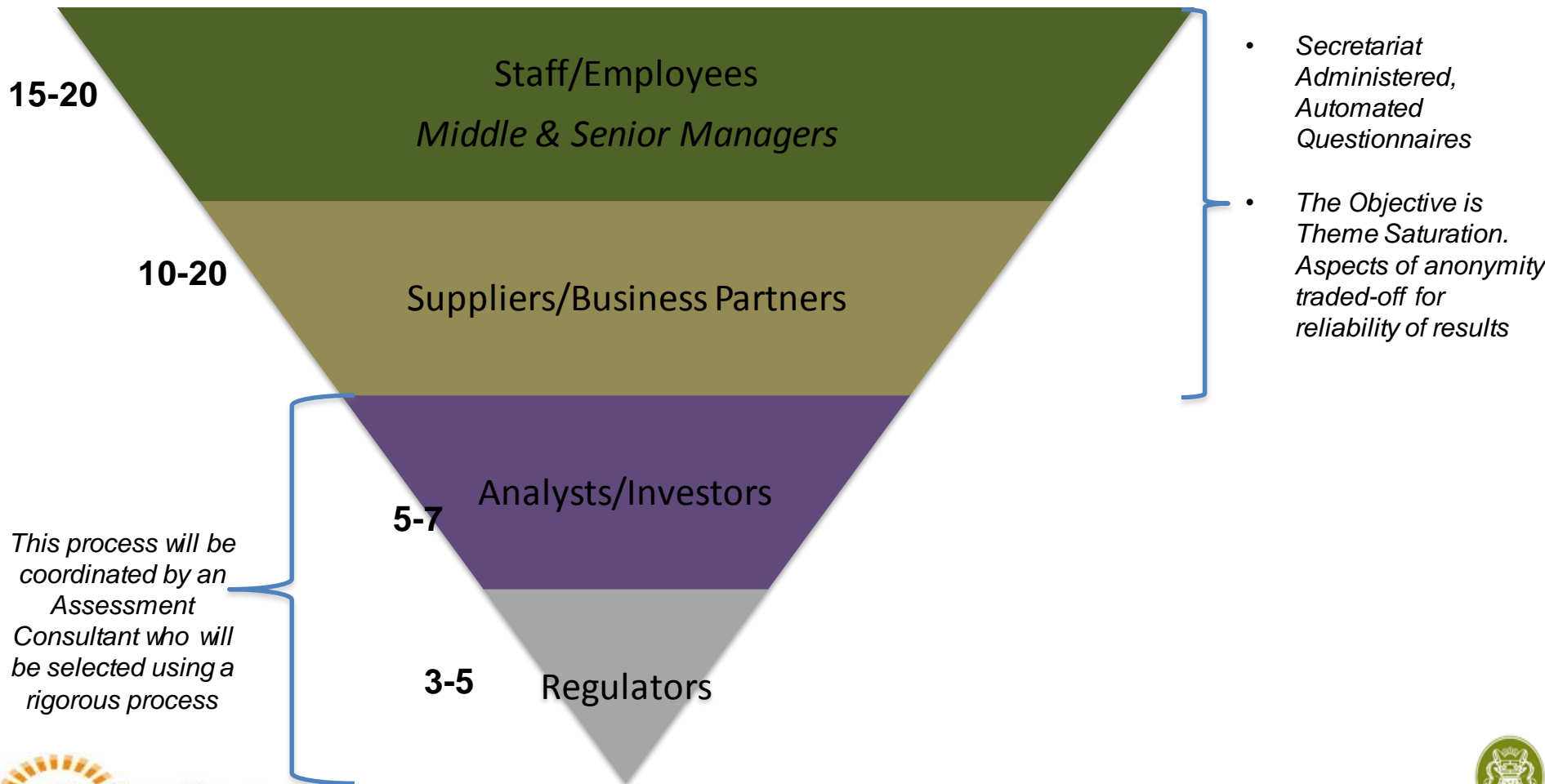
# Corporate Integrity Assessment



***\*Only companies that score 40 and above will be put through for the Corporate Integrity Assessment***



# Stakeholder Structured Interviews



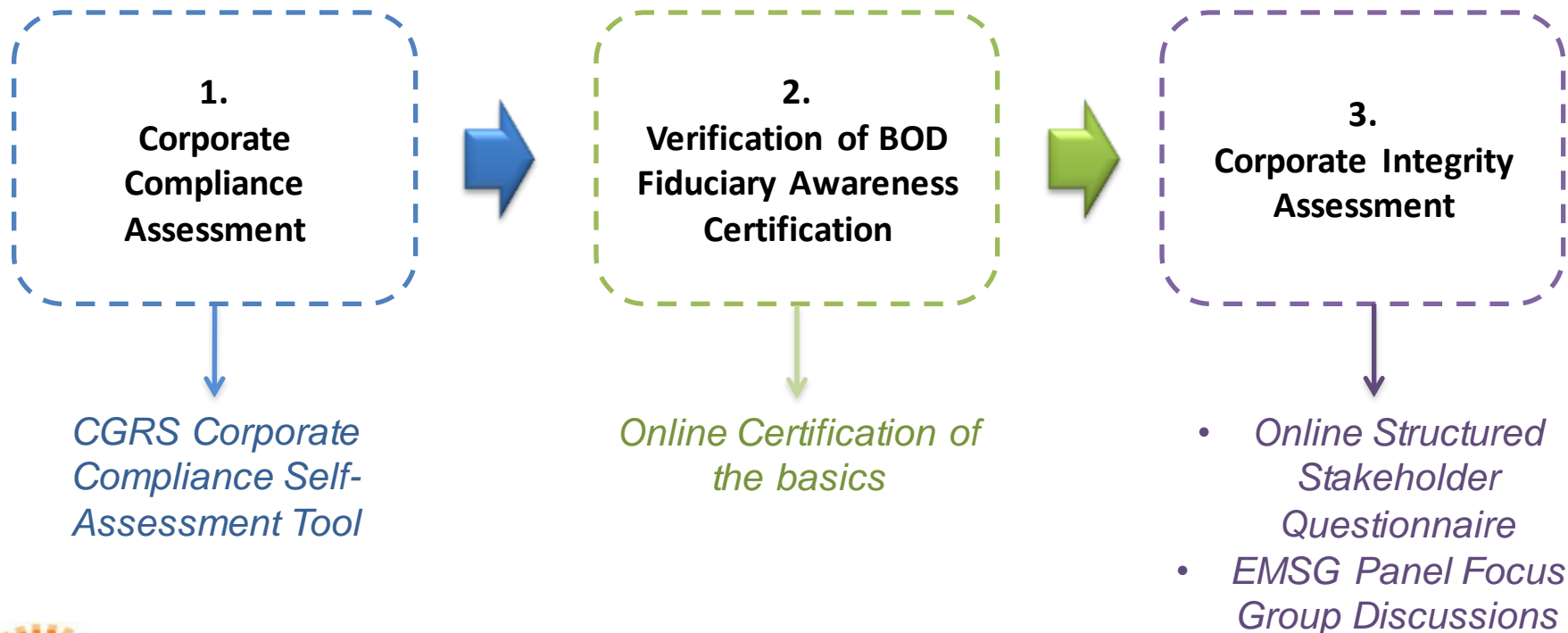
## EMSG Panel Discussions

- The Expert Multi-Stakeholder Group (EMSG)'s role is to provide views, advice, recommendations and informed opinions to the Ratings Committee on the CG Practices of Listed Companies.
- This shall include, but not be limited to:
  - A Panel Review the CG Practices of listed companies as they understand it
  - Provide advice and views on existing and emerging issues affecting individual listed companies which may adversely affect its rating and position in the CGRS
  - Highlight new issues for consideration that may affect the integrity of the CGRS and overview strategies to mitigate those issues

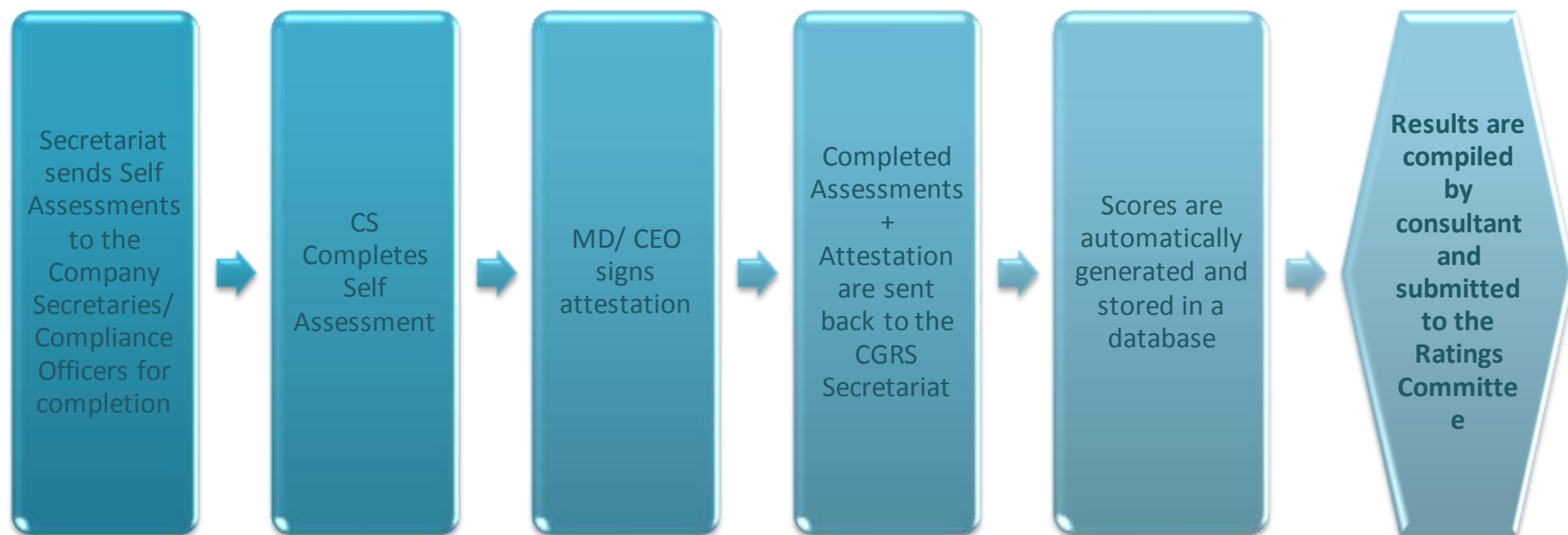
# THE RATINGS PROCESS

# Overview of the Ratings Process

*This process consists of 3 main stages that are related to the CGRS approach*



# The Corporate Compliance Assessment Process



***The whole process should take about 6 weeks***

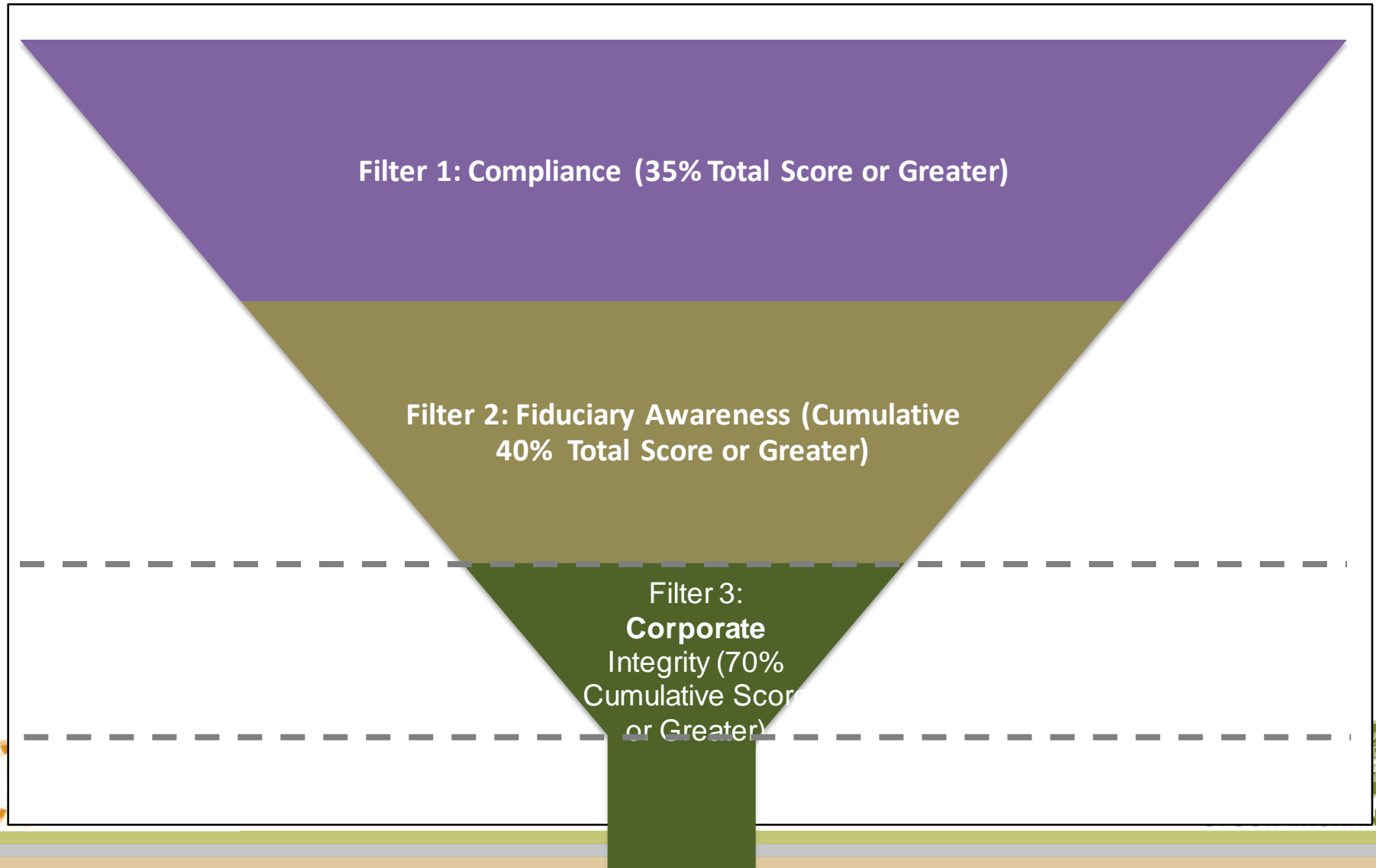
***At least once in 3yrs, all company submissions will be audited to verify their integrity.***

## The Fiduciary Awareness Certification Process

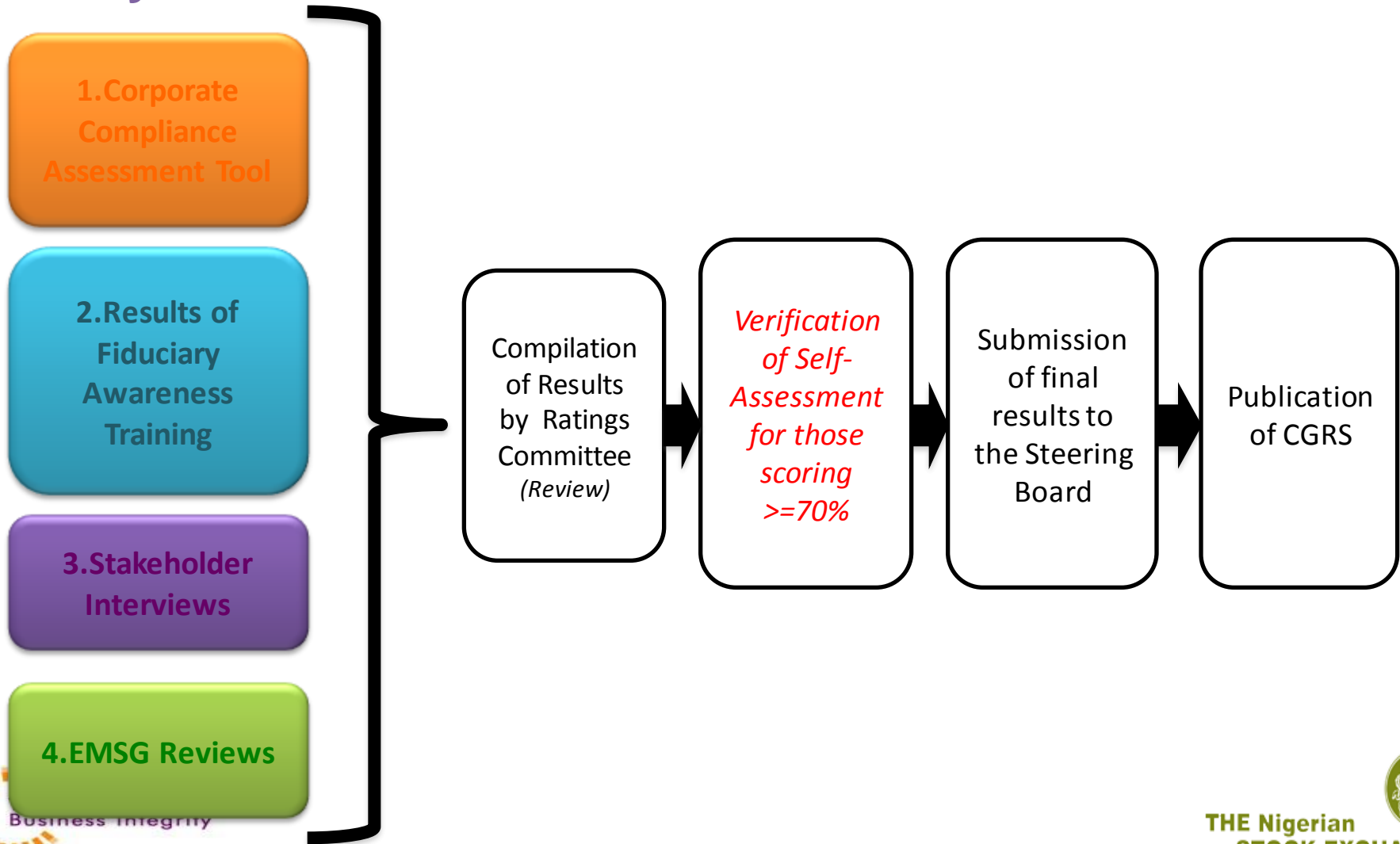


*The Fiduciary Awareness Test can be booked anytime as it is online, offline Computer Based Training*

# Corporate Governance Rating Process Funnel



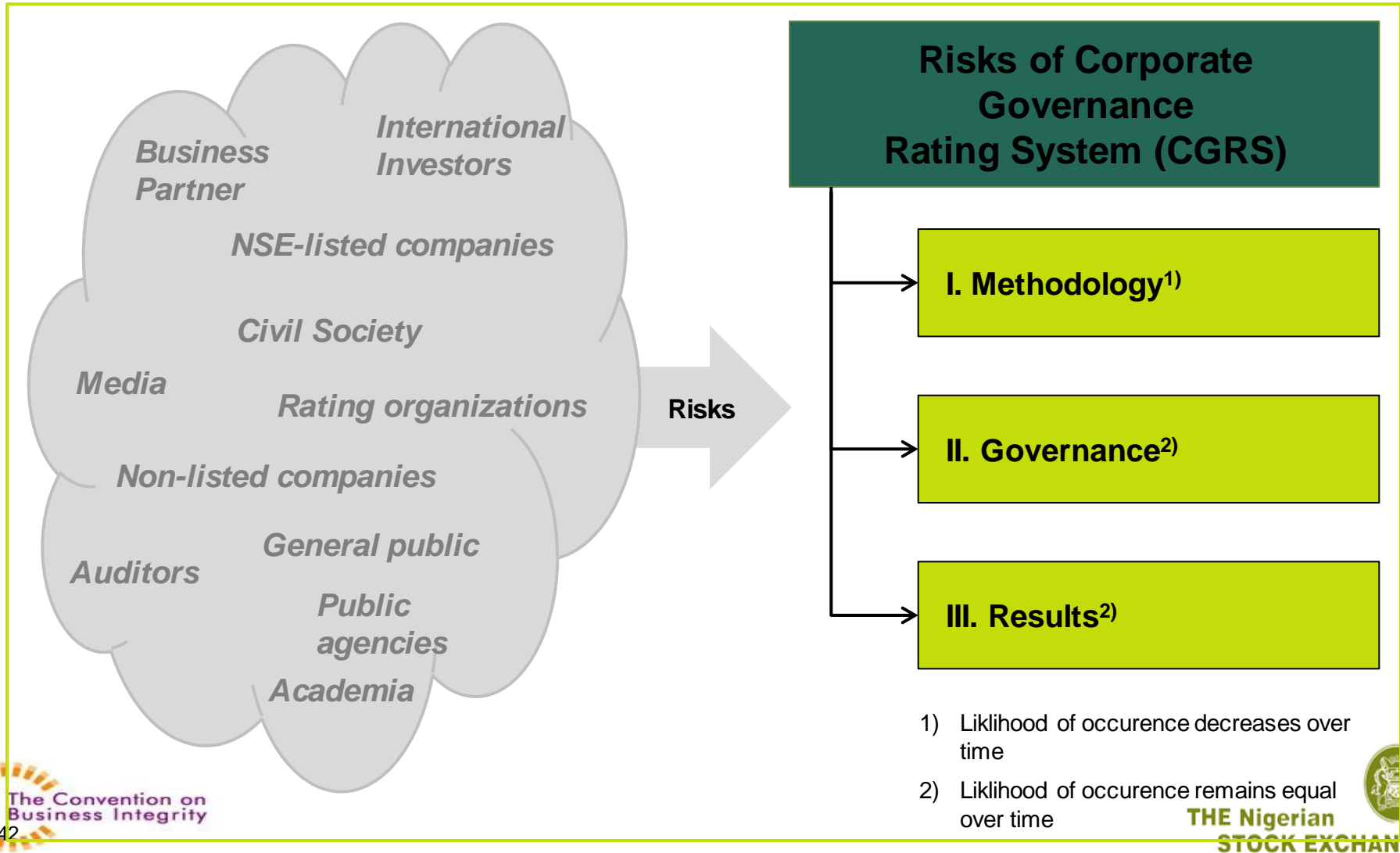
## After assessment, the results are compiled and analyzed





# RISKS

# Overview of risks



# I. Methodology Risks

Category	Risks	Mitigation activities
<b>Methodology</b>	<b>Methodology is not accepted by other stakeholders</b>	<ul style="list-style-type: none"> <li>▪ Incorporate Nigerian standards and international good practices in CGRS</li> <li>▪ Review methodology by International Observer and other stakeholders (e.g. Independent International Experts)</li> <li>▪ Communicate rationales and methodology to relevant stakeholders in a customized manner</li> </ul>
	<b>Methodology involves practical challenges</b>	<ul style="list-style-type: none"> <li>▪ Conduct pilot with limited number of companies</li> <li>▪ Evaluate pilot and forecast overall time and effort</li> <li>▪ Evaluate pilot and estimate probability of success</li> <li>▪ Start with annual ratings</li> </ul>
	<b>Self-assessment is unreliable</b>	<ul style="list-style-type: none"> <li>▪ Publish self-assessments of companies</li> <li>▪ Conduct an audit by independent third party</li> <li>▪ Establish sanctions in case of overstatements</li> </ul>
	<b>Perception-based assessment of Expert Multi-Stakeholder Group is biased</b>	<ul style="list-style-type: none"> <li>▪ Choose senior industry experts for assessment</li> <li>▪ Limit weight for overall 'Corporate Integrity' score</li> <li>▪ Separate perception-based from fact-based input</li> <li>▪ Establish process for potential conflict of interests</li> <li>▪ Publish Name of EMSG Chair</li> </ul>



## II. Governance Risks

Category	Risks	Mitigation activities
<b>Governance</b>	<b>(Perceived) conflict of interests of NSE</b>	<ul style="list-style-type: none"> <li>▪ Communicate role of NSE in overall process</li> </ul>
	<b>(Perceived) conflict of interests of CBI</b>	<ul style="list-style-type: none"> <li>▪ Communicate role of CBI in overall process</li> <li>▪ Engage international observer</li> <li>▪ Define clear process for selection of Expert Multi-Stakeholder Group (EMSG) and prohibit CBI to participate</li> <li>▪ Assign external consultants randomly</li> </ul>
	<b>(Perceived) conflict of interests for Expert Multi-Stakeholder Group</b>	<ul style="list-style-type: none"> <li>▪ Communicate role of EMSG</li> <li>▪ Limit duration of members in EMSG to 2 years</li> <li>▪ Limit perception input for overall 'Corporate Integrity' score (e.g. to max. 40% and EMSG only half of that)</li> </ul>
	<b>(Perceived) conflict of interests for external consultant</b>	<ul style="list-style-type: none"> <li>▪ Communicate role of external consultant in overall process</li> <li>▪ Select external consultants with outstanding track record and experiences</li> <li>▪ Prohibit external consultant to accept undue advantage</li> <li>▪ Bar external consultant for period of time from business at reviewed company</li> </ul>



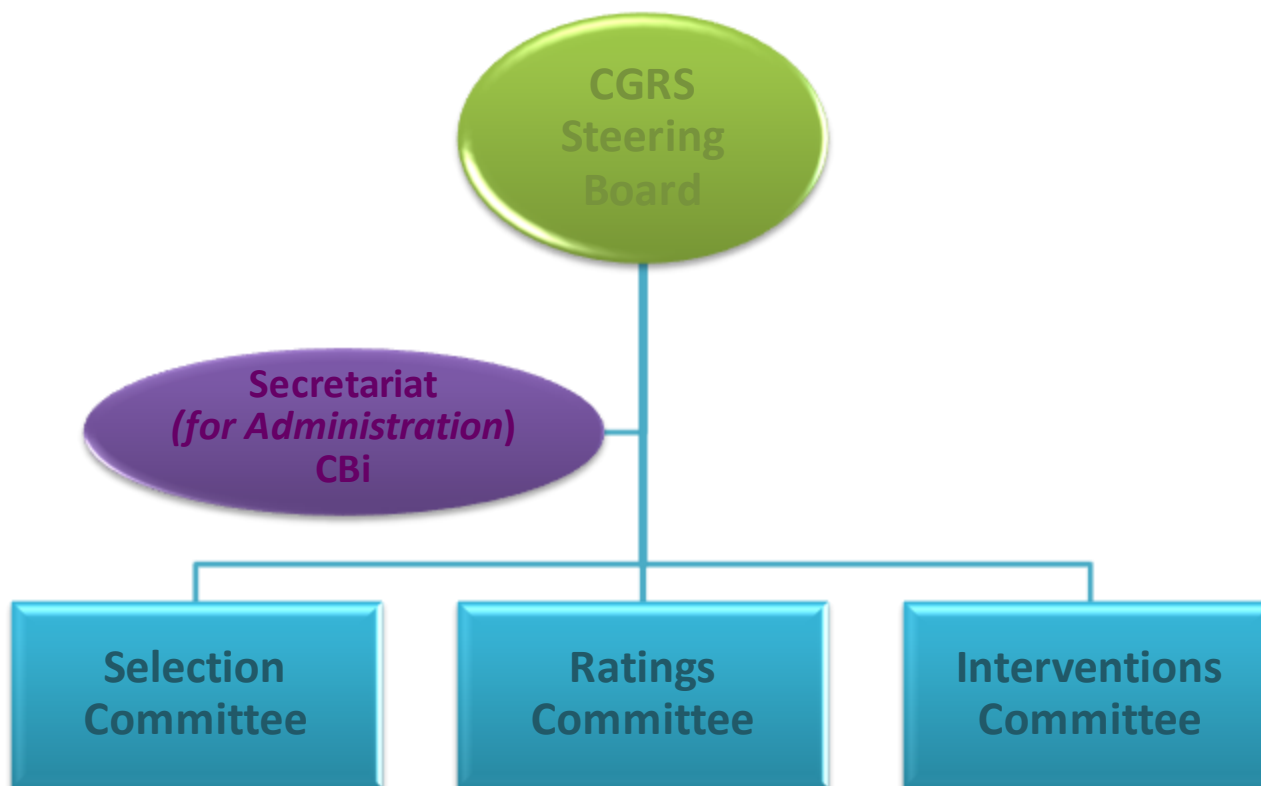
### III. Results Risks

Category	Risks	Mitigation activities
<b>Results</b>	<b>Discrepancies between rating and company conduct based on rumors</b>	<ul style="list-style-type: none"> <li>▪ Add to disclaimer</li> <li>▪ Request clarification (<i>private request</i>)</li> <li>▪ Assess allegations through CGRS Sanctions Board (comprising NSE, CBI and representatives of the companies on the rating)</li> <li>▪ Determine next steps on a case-by-case basis</li> </ul>
	<b>Discrepancies between rating and company conduct based on public allegations (e.g. media)</b>	<ul style="list-style-type: none"> <li>▪ Add to disclaimer</li> <li>▪ Request clarification (<i>first: private request, if not appropriate response by company: public request</i>)</li> <li>▪ Assess allegations through CGRS Sanctions Board: <ul style="list-style-type: none"> <li>○ In case allegations are regarded as severe, company will be removed from rating</li> <li>○ Otherwise, company will remain on rating</li> <li>○ In both cases, an appropriate communication will be issued</li> </ul> </li> </ul>
	<b>Discrepancies between rating and company conduct based on official charges</b>	<ul style="list-style-type: none"> <li>▪ Add to disclaimer</li> <li>▪ Request clarification (<i>public request</i>)</li> <li>▪ Disqualify company from participating in rating until final verdict and in case of conviction remove company from the rating (public communication)</li> </ul>



# THE CGRS GOVERNANCE STRUCTURE

# The CGRS Governance Structure



## The Steering Board (SB)

The SB serves as the governing body responsible for defining the system's scope and structure, guiding development and will be responsible for approving the companies on the CGRS prior to its official release and launch

**Membership:** The Board shall be composed of 7 individuals (including the Chair) from the following:

- 2 representatives from CBI
- 1 representative from NSE
- 1 representative e.g. from the SEC or FRC
- 1 organized Civil Society Expert – e.g. a Media/PR Expert
- 1 Corporate Governance Expert
- 1 Local Representative of an International Private Sector Development/Ratings Agency etc.



## The Selection Committee (SC)

The SC serves is responsible for coordinating the selection of EMSG members (Long list and Sector) and Consultants for the stakeholder assessments & verification of self-assessments done by companies

**Membership:** The Committee shall be composed of 5 individuals (including the Chair) from the following:

- 1 representative from CBI/NSE
- 1 from Professional/Business Associations
- 1 independent Analyst/Academic
- 1 independent with Investigative/Due Diligence Skills
- 1 organized civil society (*of high repute and standing in society*)

## The Ratings Committee (RC)

The RC serves is responsible for coordinating the entire ratings process and will also have the specific task of auditing the process and ensuring quality control mechanism are in place and implemented.

**Membership:** The Board shall be composed of 5 individuals (including the Chair) from the following:

- 1 representative of the CBI
- 1 representative of a ratings organisation
- 1 independent Analyst/Academic
- 1 independent Corporate Governance Expert
- 1 independent from organized civil society (*of high repute and standing in society*)

## The Interventions Committee (IC)

The IC serves is to clarify the procedures for interventions including coordinating investigations on ranked companies that have a Prima facie Indications of a breach of the corporate governance standards of the CGRS and recommendations of the appropriate actions for the implicated rated companies

**Membership:** The Board shall be composed of 5 individuals (including the Chair) from the following:

- 1 representative of the CBI
- 1 legal expert from NSE
- 1 organized civil society expert (a legal expert)
- 1 representative of rated companies (plus 3 alternates from different sectors representing small, mid and large cap companies)\*
- 1 independent Media/PR Expert

*\* Listed companies will select the representatives to serve on this committee*

## The CGRS Secretariat

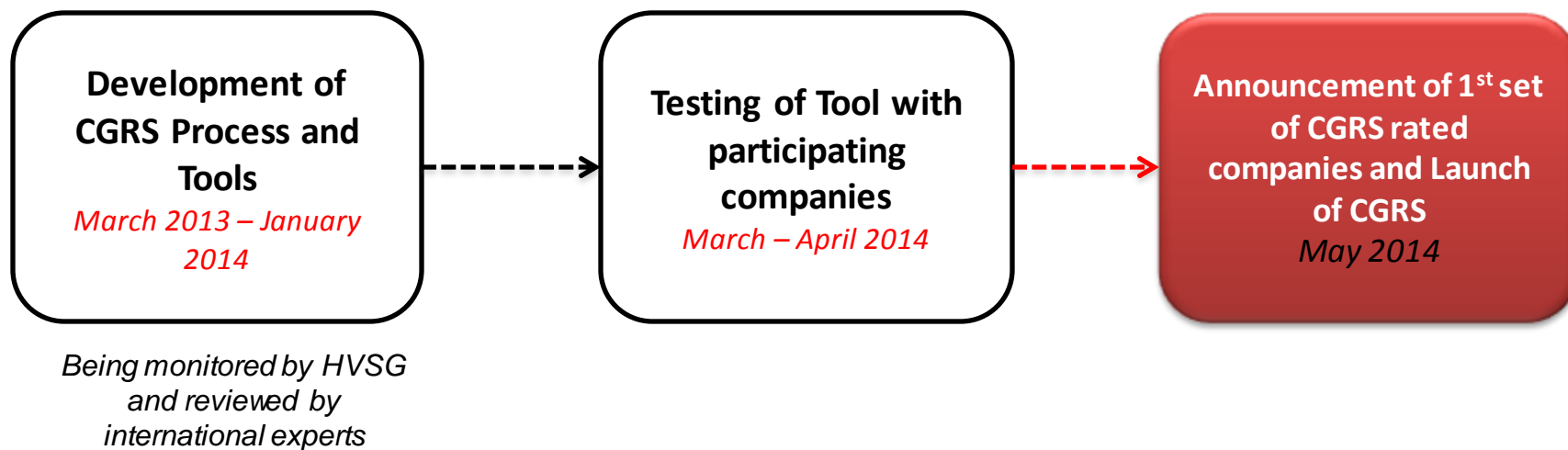


**CBi**

The Secretariat is responsible for coordinating the daily administrative tasks for the CGRS.

The secretariat ensures continuity between one board regime and the next

## CGRS Timelines



# Q&A

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Corporate  
Governance  
Rating System

*Better for Business*

THANK YOU