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# REFORMING CORPORATE GOVERNANCE IN GHANA - PART 1: THE PRIVATE SECTOR

***by***

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**Introduction**

"Good governance" now parallels democracy as one of the most widely used terms in contemporary public discourse in Ghana. The new thinking within the development community and civil society is that for democracy to translate into improved living conditions, it must go hand-in-hand with responsible, competent and effective management of the nation's political, administrative and financial resources. Good governance has therefore assumed a prominent place on Ghana's political and economic reform agenda. Efforts in this direction have focused, so far, on *state-level* governance. The goal here has been to improve the capacities of the various political, administrative and accountability agencies and institutions of state and, in the process, make them more honest, transparent and effective in the discharge of their public mandates.

While Ghana works to improve and reform state-level governance, there is growing recognition worldwide that *corporate governance* too deserves a place of prominence on a good governance agenda. This growing emphasis on corporate governance owes much to the East Asian "financial" crises of the late 1990s. "Unlike earlier crises, East Asia's was not a crisis of fiscal profligacy or balance of payments. It was in large part a crisis of poorly governed firms making bad investments that ultimately threatened the stability of the entire global financial system." (World Bank 2000).

Given the size of Ghana's economy and the relatively insignificant levels of foreign-sourced equity or debt in the capital structure of Ghana's companies, it is of course improbable that a crisis of corporate governance in Ghana would impact the global or even regional economy in nearly the same way as the East Asian crisis did. Still, the issue of corporate governance should not be brushed aside as unimportant to us in Ghana. Ghana's corporate sector is an important producer, consumer, employer, and taxpayer in the national economy. Therefore, a crisis of corporate governance in Ghana would adversely impact the health and growth of the domestic economy on a number of fronts.

The issue of corporate governance in Ghana is indeed ripe for policy attention and interest, in light of the Kufuor Administration's stated vision of a "Golden Age of Business in Ghana." If the business sector in Ghana is to play effectively its expected role as the primary engine of economic growth, not only must government create and maintain a business-friendly policy environment, the quality of corporate governance too will have to improve substantially. Improving corporate governance in Ghana is also one important way to enhance the country's international competitiveness in attracting foreign investment. As global competition for investment capital intensifies, countries that can boast strong and investor-protective corporate governance structures have a competitive advantage. But even if foreign sources of investment capital remain insubstantial, adherence to good corporate governance practices can help boost the confidence of domestic Ghanaian investors and encourage more widespread shareholding, thereby promoting the growth of Ghana's infant stock market.

Last, from the perspective of promoting a culture of good governance in Ghana, it is important that the conventional focus on state-level institutions (or macro-level governance) not be pursued to the total exclusion of *micro-level* governance. For, it is at the micro-level—in our civic organizations, professional associations, corporate boardrooms, trade unions, student organizations, political parties, and NGOs—that we learn and form our good *and* bad "governance habits." Attending to the issue of corporate governance and, for that matter, micro-level governance generally, should therefore be seen as an integral part of the effort at promoting and institutionalizing good governance at the national level.

In this issue of *Briefing Paper* we will highlight some of the key problems and challenges of corporate governance in Ghana and outline ways to improve the climate and quality of corporate governance in the country. The discussion, which is in two parts, covers both private and public sectors.

We begin, in Part I, with the private sector.

As is the case in many less developed economies, the private sector in Ghana continues to be dominated by small unincorporated businesses organized primarily as sole proprietorships or as *de facto* partnerships. Under the law, such unincorporated businesses are not treated as independent legal entities with identities and assets that are separate or distinct from those of their owners. In practice too, such businesses are typically owner-managed and without limited liability. For these reasons, unincorporated businesses do not generally raise "corporate governance" problems. As an issue, corporate governance is normally identified with the *corporate form* of business organization. With the corporate form, the company is viewed and treated under the law as an "artificial person," or a separate legal personality with an identity, assets, and obligations that are legally distinct from those of its owners or shareholders.

The corporate form gives rise to concerns about corporate governance because of two kinds of risks normally associated with it. First is the risk that a controlling shareholder will manage and control the company and its assets as if the business were a sole proprietorship, thus disregarding the interests of minority shareholders, creditors or the company itself. Second, there is the risk of employee-managers, including directors, using the company's assets and opportunities to benefit themselves instead of the company and its shareholders. These risks (or agency costs) are indeed present whenever one person (the "principal") must rely on another (the "agent") to promote or safeguard the principal's interest. But such agency costs are more pronounced in businesses that employ the corporate form, where it is impractical for all or most of the shareholders to be involved in the management of the company.

Because the corporate form of business organization is vulnerable to serious abuse by both management and controlling shareholders, businesses that adopt and operate under the corporate form are subject to substantially more extensive and stringent legal regulation than unincorporated businesses. In Ghana, the legal regime that governs entities using the corporate form is the Companies Code, 1963 (Act 179).

### *Comprehensive Legal Regime for Companies*

The Companies Code contains, among other things, provisions that regulate the internal governance of businesses registered in Ghana either as "public companies" or as "private companies." Under the Code, a *public company* is a company that is permitted to raise equity or share capital from the general public and whose outstanding shares may be listed for trading on the stock exchange. In contrast, a *private company* is not permitted to raise equity from the general public and, accordingly, its shares are held by a limited number of shareholders and cannot be listed or traded on the stock exchange.

The Companies Code has a wide range of provisions designed to ensure that the corporate form does not become a device for management or controlling shareholders to fleece investors or other third parties or to oppress minority shareholders. Among these are provisions dealing with such matters as how and by whom the board of directors of a company is to be constituted; what category of persons are disqualified from participating in the management of a company; mechanisms for ensuring officer and director accountability to shareholders (e.g., through annual general meetings of shareholders; the right of shareholders to inspect the company's books; and shareholder entitlement and access to annual audited reports); the powers and duties of directors and officers; what conduct on the part of a director will constitute a conflict of interests; what remedies exist for a breach of duty by a director (including breaches involving conflict of interests and insider self-dealing and actions that exceed the permitted powers of a director); and rules designed to preserve and maintain the stated capital of the company.

The Code vests in a Registrar of Companies (i.e., the Registrar-General's Department) broad power to ensure compliance with the Code's provisions by such means as investigations, requests for information, and appointment of inspectors. Where further enforcement action is warranted, the Registrar is empowered to initiate judicial proceedings to wind up the company; to bring, in the name of the company, judicial proceedings against a director, former director, officer or any third party; or, in cases where criminal liability is established, to recommend criminal prosecution.

### *A Different Reality*

Though enacted during a period when a stock exchange was a distant dream for Ghana and the country's commercial sector was dominated by state-owned corporations and local agents and subsidiaries of multinationals, the Companies Code anticipated and provided adequately for the central issues of corporate governance in the Ghanaian private sector. However, registration under the Code has not brought corporate governance practices in Ghana's companies to the high, yet reasonable standards set by the law. To the contrary, anecdotal evidence suggests that the governance provisions of the Code are honored largely in the breach. Many companies in Ghana continue to operate like sole proprietorships. Shareholder accountability and minority-protection systems in most companies appear to exist only on paper, leaving room for much self-dealing by corporate management and insiders. At the same time, the corporate form, especially the private company option, has grown in popularity among Ghana's entrepreneurs and businesses.

The increasing preference for the corporate form in Ghana is likely the result of a combination of two factors: the value of *limited liability* plus the gross under-enforcement of the Code. Limited liability means that, as a general rule, creditors of the company have no claim against the shareholders or their personal assets in the event of liquidation. If the company goes bankrupt or into liquidation, shareholders stand to lose, at worst, only the monies they have invested as capital; beyond that, they are generally not liable to unpaid creditors. Under the Companies Code, limited liability is available by choice to companies at the time of incorporation.

The concept of limited liability, like the corporate form with which it is closely associated, is vulnerable to abuse. This is especially so in situations where, despite the corporate form, a company's assets and obligations are not clearly separated from the shareholders'. Incidentally, that is the case with many private companies in Ghana.

The value of limited liability to corporate owners in Ghana has been further enhanced by the fact that, the Companies Code has had very little enforcement muscle or bite behind it. Administrative enforcement of the Code by the Registrar of Companies has been extremely weak, in part because of the severe capacity and morale constraints that have long plagued the Registrar-

General's Department. Private enforcement via civil litigation has been similarly weak; a situation that is attributable, in part, to the prolonged delays and uncertainties that generally characterize civil litigation in Ghana.

If the Code were adequately enforced, controlling shareholders who treated and used the company like their *alter ego* would risk losing their limited liability status, as the Code provides for the lifting of the "corporate veil" and the attribution of liability directly to the controlling shareholder where the privilege of limited liability or the corporate form is abused. However, in an environment where the Code is grossly under-enforced, limited liability becomes, in effect, a privilege that carries with it little responsibility or accountability on the part of the beneficiary shareholders.

### *Control and the gross undercapitalization of companies*

Weak enforcement of the corporate governance standards of the Companies Code is made more worrisome by the fact that most limited liability companies in Ghana (particularly private companies) are substantially undercapitalized. This means that corporate owners are risking relatively little of their own capital or else failing to maintain or preserve their stated capital, while the company's debts grow vastly out of proportion to its capitalization. Such gross undercapitalization in the private corporate sector heightens the risk of corporate insolvencies. Moreover, to the extent that undercapitalized companies in Ghana rely excessively on short-term bank lending, they put a squeeze on the availability of bank credit for small start-up entrepreneurs.

Undercapitalization in the Ghanaian corporate sector is partly the result of an unwillingness on the part of founding shareholders to share control of what they consider to be *their* company. One might be inclined to see this simply as something cultural. The Ghanaian corporate founder is indeed reluctant to share ownership and control of his or her company with unrelated third parties. As a result, the average Ghanaian private company remains a closed, thinly capitalized, debt-laden family business that is often under the control of the family patriarch.

Undercapitalization and excessive reliance on commercial credit and bank debt are, however, not peculiar to family-owned Ghanaian businesses. Many multinationals and other foreign owned companies with substantial turnovers and asset values have operated and continue to operate in Ghana as undercapitalized private companies, relying, like their Ghanaian private company counterparts, on huge amounts of domestic bank and commercial credit to finance their domestic operations. Ensuring sound corporate governance in Ghana's private sector will mean, among other things, taking steps to address the problem of lopsided, debt-heavy corporate balance sheets.

### *Promoting the Public Company Option*

With the Ghana Stock Exchange (GSE) now in operation for over a decade, privately held companies should be encouraged to "go public." Government can help this along by showing a clear policy preference for the public company form over the private company option. Such a policy preference is justified because, compared to their private company counterparts, public companies in Ghana tend to score better on such measures as employment generation, tax contribution, transparency of operations, and survivability beyond the lives of the founding generation.

To some extent, there is already an implicit policy preference for public companies embedded in the current corporate tax structure. Whereas public companies are taxed at a corporate tax rate of 30%, their private company counterparts are taxed at a rate of 32½%. This differential in rate could be widened to make the tax advantage even more favorable to public companies.

To make the policy preference for public companies even more explicit, government should consider legislation designed to cause more private companies to migrate to the public company form. As an example, government can enact legislation requiring certain categories of companies to operate only as public, not private, companies. Legislation of this kind will make sense in Ghana if applied, for example, to certain specific industries (e.g., oil marketing, commercial banking) or to companies whose assets or annual turnover exceed a certain minimum threshold. Notably, among multinational oil marketing companies doing business in Ghana, only Mobil Oil (Ghana) Limited does business as a public company; the rest (Shell, TotalfinaElf) operate in Ghana as private companies. Similarly, Standard Chartered Bank (Ghana) Limited is the only non-state bank to be registered as a public company.

The Securities and Exchange Commission (SEC), GSE and the local brokerage/underwriting community must collaborate to promote and explain to the local business community the relative advantages of going public. As part of this promotional effort, stories of successful migration from the private to the public company form must be highlighted. A good example in this regard is Mechanical Lloyd Company Limited, which started in 1970 as a family-owned private company but went public in 1992 and has since improved its balance sheet and market standing significantly. The business community must be educated to understand that going public does not necessarily imply loss of control. Issuing non-voting preferred stock, instead of common stock, is an option that remains available to corporate owners and founders who may have hypersensitive concerns about loss of control.

***Strengthening enforcement of the Code***

Enforcement of the Companies Code, especially administrative enforcement, must be strengthened substantially. One will have to assume that the capacity and morale constraints facing the Registrar-General's Department will not disappear in the short term. With this as background, the burden of administratively enforcing and policing compliance with the Code could be divided up between the Registrar, on the one hand, and the SEC and GSE, on the other, with the latter two organizations enforcing the Code as it applies to public or listed companies while the Registrar is left to focus its scarce resources on private companies.

In fact, GSE recently acted to uphold good corporate governance when it protested as a violation of the Companies Code the action of the government in replacing, without acting through the appropriate governing board, the managing director and general manager of Produce Buying Company, a listed public company in which the government has a controlling interest. (Bus. & Fin. Times, Jan. 21-27, 2002).

Structurally too, the placement of the Registrar of Companies within the civil service under the Attorney-General's office seems anachronistic. A better arrangement, from an efficiency standpoint, would be to take the Registrar of Companies out of the civil service and reconstitute it as a revenue-generating, fee-supported public service agency. The reconstituted agency should then be placed under the supervisory jurisdiction of the Minister for Private Sector Development.In addition, the Registrar's enforcement capacity with regard to the Companies Code would be greatly enhanced if the Registrar were relieved of its current functions under the Registration of Business Names Act, a statute that applies to sole proprietorships. Because sole proprietorships tend to be highly localized store-front operations, the administrative oversight function relating to such entities are best decentralized to authorities at the local/district level.

Some portion of the burden of monitoring compliance with the Companies Code could also be shifted to companies themselves. This can be done, for example, by replacing the current "one-time-only" registration with a regulatory scheme that will require limited liability companies (or, more specifically, private companies) to renew their registration under the Code on a periodic basis (e.g., every two years). In that event, new certificates of incorporation will be issued to only those renewing companies that show full and satisfactory compliance with applicable minimum capitalization, corporate governance, and other provisions of the Code (as well as certified proof of their discharge of all outstanding tax payment obligations).

To enhance judicial enforcement of the Code, consideration should also be given to the establishment within the High Court of a division (preferably a "fast track" one) to deal exclusively with corporate or business litigation, including private and administrative enforcement proceedings under the Code. The effectiveness of any reform in this area is of course contingent on a successful suppression of corruption within the judicial service.

### *Need for Local Credit Reporting Industry*

The environment for corporate governance in Ghana could also benefit greatly from the services of a credit reporting and rating industry—an industry that will collect, research, maintain and sell to interested end-users "reputational information" about companies. Such information, concerning a company's assets, cash flow position and valuation, management capabilities, and other data, will enable end-users to assess the company's credit risk and suitability as a borrower, an investment, or a contracting party. Unless there is consistent and substantial enough demand for such corporate reputational information, however, a credit reporting and rating industry is unlikely to emerge, let alone thrive, in Ghana. The natural market for such services in Ghana consists of banks, other lending institutions, major suppliers, prospective equity partners, and certain government agencies.

### *The Accounting Profession, the Banking Sector and Other Facilitating Institutions*

The accounting profession, whose members must prepare and audit the financial statements that companies must file periodically with the Registrar and other agencies, also has an important role to play in ensuring that client companies comply with the requirements of the law. Some form of enhanced auditor liability may be warranted in this regard to ensure that auditors do not willfully or recklessly lend their blessing and credibility to clients who seek to evade compliance with the financial record keeping, reporting and disclosure requirements of the Code. Banks too, through rigorous enforcement of sound lending practices and criteria and the conduct of proper "due diligence," can help ensure that borrower-companies maintain sustainable debt-equity ratios as well as comply with the governance provisions of the Companies Code. Better governance in the banking sector is indeed an important step toward better governance in the corporate sector as a whole.

Finally, the newly-created Ministry for Private Sector Development must provide leadership in the area of corporate governance by making it one of its policy priorities to promote and reward good corporate governance habits in Ghana. In this effort, the Ministry must work collaboratively with organizations such as the Private Enterprise Foundation, the Ghana Chamber of Commerce, the Association of Ghanaian Industries, the Ghana Stock Exchange, the Trades Union Congress, and the Institute of Directors. A strong, well-capitalized, and well-governed private/corporate sector will benefit not only these organizations and their members, but also the national economy and the quality of national governance as a whole. ◘

**In Part 2 of this *Briefing Paper* we will turn our attention to corporate governance in Ghana's State-owned Corporations.**

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Latin American private sectors cannot afford the status quo. They must be visionaries and activists, and motivate both the public and the private sector reforms that are needed if Latin American economies are to participate, in any significant part, in the global economy. â€¢ I am not here to preach the wonders of the North American economy -- as we watch its capital markets gyrate. Rather Iâ€™ll provide some U.S. investor perceptions of Latin America and then talk about why it is your respective private sectors' responsibility to improve those perceptions -- if Latin America is to reach its Keywords: corporate governance, shareholder protection, transparency, financing constraints, ownership structure.Â  Third, we address the possible endogeneity of corporate governance in two ways. First, our survey data exhibits some time variation (there are two annual observations for a subset of firms) so we can use fixed-effects regressions, controlling for time-invariant unobserved factors. This removes much of the omitted variable bias, one possible source of endogeneity.Â This might be part of a reputation mechanism that has been stressed as important alternative governance mechanism in the case of China by Allen et al. (2005). However, this line of reasoning does not seem to apply to firms that are dominated by insiders.