AFRICAN DEVELOPMENT BANK

CORPORATE GOVERNANCE STRATEGY

July 2007

INDEX OF ABBREVIATIONS

ACBF	African Capacity Building Foundation
ADB	African Development Bank
ADF	African Development Fund
Afri-MAP	Africa Governance Monitoring and Advocacy Project
AGI	Africa Governance Inventory
AGOA	African Growth and Opportunities Act
AICC	African Institute of Corporate Citizenship
ALPN	African Leadership and Progress Network
AMSCO	African Management Services Company
APNAC	African Parliamentary Network against Corruption
APRM	Africa Peer Review Mechanism (NEPAD)
ASEA	African Stock Exchanges Association
BAAC	Business Action Against Corruption
BDS	Business Development Services
BEN-Africa	Business Ethics Network - Africa
CACG	Commonwealth Association of Corporate Governance
CCG	Centre for Corporate Governance (Nairobi)
CG	Corporate Governance
CGP	Country Governance Profile
CIPE	Center for International Private Enterprise
CODESRIA	Council for the Development of Social Science Research in Africa
COMESA	Common Market for Eastern and Southern Africa
CSP	Country Strategy Paper
CSR	Corporate Social Responsibility
DFI	Development Finance Institution
DFID	Department for International Development
DFRC	Development Finance Resource Center (SADC)
EAC	East African Community
ECA	Economic Commission for Africa (UN)
ECOWAS	Economic Community of West African States
ECSAFA	Eastern, Central and Southern African Federation of Accountants
EITI	Extractive Industries Transparency Initiative
EPA	Environmental Protection Agency
EU	European Union
EU-MEDA	EU Mediterranean Development Assistance
FATF	Financial Action Task Force
GCGF	Global Corporate Governance Forum
GRI	Global Reporting Initiative
ICA	Institute of Chartered Accountants
ICSA	Institute of Chartered Company Secretaries and Administrators
IFC	International Finance Corporation (World Bank Group)
IOD	Institute of Directors
IQB	International Qualification Benchmark
JAI	Joint Africa Institute
MENA	Middle East and North African
MSCI	Morgan Stanley Capital International Inc.
NEPAD	New Partnership for African Development
NGO	Non Governmental Organization
Non-RMC	Non-Regional Member Country
OECD	Organization for Economic Cooperation and Development
OHADA	Organisation pour l'Harmonisation en Afrique du Droit des Affaires
PACFCG	Pan African Consultative Forum on Corporate Governance
PBLCG	Policy Based Lending on Corporate Governance
PCCs	Post-Conflict Countries
PLC	Publicly Listed Company (Incorporated Company in the US)
PSCGT	Private Sector Corporate Governance Trust (Kenya)
PSCP	Private Sector Country Profile

RMC	Regional Member Country
REC	Regional Economic Community
SADC	Southern African Development Community
SEC	Securities and Exchange Commission
SMEs	Small and Medium-sized Enterprises
SMMEs	Small, Medium and Micro Enterprises
SOE	State Owned Enterprise
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
VSEs	Very Small Enterprises
VSMEs	Very Small, Small and Medium Sized Enterprises
WABA	West Africa Business Association
WAEMU	West African Economic and Monetary Union
WB	World Bank

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EXECUTIVE SUMMARY

This document sets out the African Development Bank's (the "Bank's") strategy in promoting corporate governance reform in Africa. It highlights the respective roles of the key stakeholders and calls for full partnership with actors operating in the field; this implies the use of various instruments, including financial and technical mechanisms.

Good corporate governance plays an important role in promoting both economic efficiency and equity (through lower cost of capital, larger capital markets, higher market valuation of firms, and profits). Indeed, a number of cross-country studies have demonstrated that countries that maintain good corporate governance performance – both in terms of the relevant legal/regulatory infrastructure (macro-level) and corporations' observance of key standards and codes (micro-level) – also enjoy a higher level of sustained economic growth.

The Bank's approach builds on its investigative processes, in particular country strategy papers (CSPs), country governance profiles (CGPs), private sector country profiles (PSCPs), and investment proposals. It also takes full account of empirical studies conducted by other partners and by specialized institutions. The research undertaken in the preparation of this document reveals a complex spectrum of corporate governance practices, institutional, legal and regulatory arrangements across the continent. One major finding to emerge is that many corporate governance problems stem from poor political and economic governance generally. Notwithstanding ongoing sustained efforts, a significant number of RMCs continue to face endemic problems such as corruption, institutional instability, lack of transparency and accountability, and a weak rule of law. Within this context, corporate governance mirrors the wider environment; progress in both arenas is intrinsically linked and needs to be tackled in parallel.

A review of the existing literature shows that the scope of corporate governance is not limited to one specific area but impacts three separate issues: (i) Board and Corporate Management (focusing on the structure of the board, codes of board practices, and corporate effectiveness); (ii) Financial Market Management (with an emphasis on the link between stock markets, shareholders, and the company); and (iii) Corporate Social Responsibility (i.e. social and environmental responsibilities of corporations to a wider set of stakeholders, including employees, consumers, and the community in which they operate). Viewed from this broader perspective, corporate governance goes beyond the relationship between management and investors to encompass a complex set of linkages among disparate groups of stakeholders.

From the Bank's viewpoint, good corporate governance matters to the whole spectrum of ownership structures, from family-owned small and medium enterprises (SMEs) to publicly owned local entities such as municipalities. In the case of SMEs, the lack of separation between ownership and control, which is typical of small family businesses, can often lead to a lack of transparency and accountability (e.g. no external auditing). This represents a major obstacle to sustained growth, e.g. by reducing access to external capital.

The overall goal of the Bank's strategy is to contribute to economic development by promoting good corporate governance in public and private sector corporations and ensuring that they create value for shareholders, not only from a financial standpoint but also in a socially and environmentally responsible way. This strategy aims at promoting the four fundamental governance principles of *transparency, responsibility, fairness,* and *accountability* at the corporate level, and ensuring that the necessary regulatory framework and institutional capacity are in place to enforce them.

Implementation of the strategy will be governed by a set of three principles that will guide the design of country-specific programs; modalities for extending the Bank's assistance; and the process for selection of areas for intervention and allocation of resources.

(i) In terms of **complementarities**, the Bank's Corporate Governance Strategy will complement existing efforts and strategic partnerships with other key regional players (particularly NEPAD-African Peer Review Mechanism) and will focus on new areas that are not already covered. In designing a country plan of action, the Bank will give priority to areas in which it has a competitive advantage and can add the most value.

(ii) Through the principle of **selectivity**, the strategy will prioritize those countries and institutions that demonstrate a strong commitment to corporate governance reform. At the corporate level, the best performers will benefit from more favorable terms and conditions. The Bank will explore the possibility of providing specific assistance and increased facility to borrowers that demonstrate a firm commitment to good corporate governance principles. In particular, it will assist financial intermediaries to offer better conditions to small and micro enterprises who actively engage with such principles.

(iii) The Bank's strategy will also ensure **flexibility** in recognition of the fact that corporate governance principles (which are largely translated in a series of international standards, norms, and codes of practice) may be implemented in a variety of ways, depending on the size, location, and specificities of the business.

In this way the Bank's strategy aims to encourage corporate bodies to adopt these basic principles and for RMCs to adapt them to their own specific context. The objective is to assist countries to develop specific codes of practice for SMEs through simple and inclusive procedures. It will encourage countries to adopt and adapt existing instruments and codes rather than embarking on the wholesale and costly production of new ones.

Where feasible, the Bank will promote actions and programs that are regionally designed and oriented. The Bank will assist countries to build on existing regional mechanisms (such as OHADA) and institutions that already promote good corporate governance including corporate social responsibility on the continent (such as PACFCG, CCG, ECSAFA, and AMSCO).

The Bank's efforts to improve corporate governance will target three key players: (i) government organizations and regional economic institutions (RECs); (ii) financial intermediaries; and (iii) corporations, particularly state-owned enterprises (SOEs) and small and medium-sized enterprises (SMEs). The Bank will assist RMCs (governments and key players), in close cooperation with NEPAD and RECs, to develop and enforce their codes of corporate governance. This will be achieved through financial support and technical assistance to governments. Such actions will be conducted in harmony with other Bank-related interventions which directly impact corporate governance, such as fighting corruption or tax evasion. The Bank's strategy will guide its future lending and assistance program, ensuring that corporate governance concerns and issues are fully taken into account in any region and country program, both at country and corporate levels.

One of the key strategic actions for assisting SMEs to develop good corporate governance will be to strengthen the capacity of financial intermediaries to enforce standards of governance among client firms. In this way the financial intermediaries will act both as agents disseminating the codes, and as enforcers ensuring their adherence. Financial institutions, in particular microfinancing institutions, will be encouraged to develop governance criteria as an intrinsic part of their lending policies. In order to disseminate corporate governance principles effectively, the Bank will also involve regional development finance institutions (DFIs) in its programs. Through its strategic actions in this area, the Bank will be able to broaden its support to the private sector, thereby contributing to the continent's sustained growth and competitiveness.

The Bank's Corporate Governance Strategy is an important component of its overall governance strategy. It seeks to enhance economic and political governance in African countries by promoting sound practices at corporate level. This bottom-up approach will complement other Bank policies and programs aimed at making African economies stronger and more attractive to investors, both at local and international levels.

The Corporate Governance Strategy is consistent with the Bank's Private Sector Development Strategy aimed at creating an enabling environment for the emergence of a viable private sector in RMCs. It aligns with NEPAD's call for the Bank to play a leading role in the area of corporate governance and will build on the support role that the Bank is already providing to the process led by the NEPAD-African Peer Review Mechanism (APRM).

1. INTRODUCTION

The African Development Bank ("the Bank") has fully recognized over the last few years that *good governance is key to Africa's future development*. Studies have shown that it contributes to macroeconomic stability and predictability; it enhances government's ability to implement poverty reduction policies by ensuring transparent and participatory policy-making; it enables public functions to be executed in an accountable manner and therefore increases investor confidence, and it demonstrates a country's strong commitment to international anticorruption standards. In this way, improved corporate governance can markedly contribute to a country's ability to achieve sustained economic growth and lasting democratic political institutions.

The Bank formulated a Bank Group Policy on Good Governance at the end of 1999 and related Operational Guidelines in 2001. These documents aimed to provide a flexible framework for mainstreaming governance into Bank operations and to pave the way for African countries to enhance their governance stance. One major outcome of the guidelines has been the formulation and implementation of the Country Governance Profile (CGP) as a Bank instrument. The CGP is designed to help RMCs and the Bank to identify weaknesses in governance practices and to develop appropriate capacity-building programs. Identified shortcomings are addressed through specific projects/programs, including a new quick-disbursing instrument, viz. the Policy-Based Lending on Governance (PBLG).

A number of CGPs have been undertaken including Benin, Burkina Faso, Chad, Gambia, Kenya, Mauritania, and Senegal, and these have helped to inform and to improve Bank assistance strategy on governance matters. However, the first set of CGPs failed to fully address corporate issues, although they did indicate the need for a dedicated Corporate Governance Strategy, particularly in relation to the enterprise sector and its specific problems.

In its Strategic Plan (2003-2007), the Bank reaffirmed its strong support for the promotion of good governance as key to meeting the Millennium Development Goals. Indeed, the Private Sector Development Strategy, adopted in 2004, acknowledged corporate governance as a cornerstone for the development of a viable and sound private sector in RMCs, particularly SMEs. Its crucial role in attracting foreign investments flows to Africa was also recognized.

The Bank's Governance Policy indicates the need to support local, regional, and international efforts to adopt rules and standards that will bolster Africa's economic development. This includes partnering with key global initiatives, such as the Global Corporate Governance Forum and the UN Global Compact and adhering to the Ecuador Principles.

Governance is also of direct concern to the Bank as an equity investor in private sector ventures and regional DFIs, and as a financier of development projects, which often rely on the involvement of private sector corporations and SOEs. The successful outcomes of such investments and projects clearly rely on a sound corporate governance environment.

At an operational level, the Bank Group provides concessionary loans and grants to RMCs to ease their economic reform programs, combat corruption, and promote good governance. Through its private sector activities, the Bank directly promotes good corporate governance by evaluating the management and governance of benefiting companies. The Bank also maintains a blacklist of companies that have failed to comply with its procurement requirements. Further institutional support is also provided to the Africa Law Institute and the African Management Services Company (AMSCO) in their drive to enhance professional standards and build capacity in the African private sector.

Noting the pivotal role of ADB in this area, the NEPAD Heads of State and Government requested the Bank to take the lead in identifying indicators and benchmarks on corporate governance and to provide assistance to both NEPAD's Secretariat and to the African Peer Review Mechanism (APRM).

The ADB's mandate, in its role as the premier financial institution on the continent, and its strong affiliation with the NEPAD program of action, places considerable responsibility on the Bank to deliver on corporate governance for its RMCs. This strategy intends to guide the Bank's activities toward fulfilling its mandate and meeting its shareholders' requests and expectations.

This document comprises eight sections. This first introductory section has set out the background to the Bank's activities in the governance field, its objectives and scope. Section two discusses the status of corporate governance, reviewing the position in Africa as well as key initiatives relevant to corporate governance reform. Section three outlines the Bank's Corporate Governance Strategy while the next section focuses on the operational aspects of the strategy. Sections five and six set out the Bank's actions at country and corporate levels respectively. Section seven discusses the Bank's engagement with other partners in respect of implementing this strategy. The major conclusions are presented in the final section eight.

2. STATUS OF CORPORATE GOVERNANCE IN AFRICA

2.1. Fundamental Problems Facing Corporate Governance Reform

Research conducted by the Bank reveals a raft of factors impeding the mainstreaming of corporate governance in several African countries. Chief among them is the problem of poor political and economic governance, including corruption and a weak rule of law.

The culture of disclosure regarding African corporations, generally, is yet to reach parity with international standards. According to the Summary of Progress Report on Corporate Governance in Africa 2005: "The challenge is to convince corporations that disclosure is an asset, rather than a burden, but this impediment will remain for so long as corporations continue to suspect that disclosure of information may be used in a manner perceived as discretionary by the authorities".[1]

A further challenge facing reform in Africa is how to ensure the quality of the regulatory and institutional framework to promote transparency and accountability. Notable in this regard is the capacity for reform and enforcement, considering that public services are unevenly provided and of poor quality in many countries, and civil servants are often so badly paid that they resort to petty corruption in order to survive.

Furthermore, many of the institutions that are intended to provide checks and balances within the system (including prosecuting systems) are generally underresourced and lack requisite skills, infrastructure, and independence. With regard to the regulatory environment, there are lacunas or gaps in the procedural and evidence laws of some countries, some of which are out of date and do not accommodate present-day technological advancements (particularly the evidential status and admissibility of computer and other electronically generated documents).

There is also a limited awareness of responsibility on the part of many stakeholders. While the concept of corporate social responsibility is gaining prominence on the continent, it is still perceived in many cases as ordinary corporate social investment or philanthropy.

Further, the appropriateness of global standards to local market conditions and economic structures is another issue that needs to be taken into account.

2.2. Progress to Date in Subregions

Southern Africa: Much work has been done to promote an understanding and implementation of good corporate governance practices in nearly all the countries of Southern Africa using the "King Report on Corporate Governance for South Africa" (King II) as a benchmark. In addition, many of the countries in this region have made efforts to reform and improve the policy, legal, and regulatory frameworks. This is attributable in part to the role that the Southern African Development Community (SADC) plays in seeking to harmonize business laws and practices.

East Africa: In the East African region, Kenya, Uganda and Tanzania have made steady advances in establishing self-regulatory institutions to promote good corporate governance. The progress

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1 See www.corporategovernanceafrica.org.

achieved to date may be attributed to the linkages that these countries share in terms of their common colonial history.

Central Africa: In the Central African region, the general reliance on francophone civil law background has created a uniform framework for harmonization of business laws, practices, and procedures. Unfortunately, due to the conflict situation that has prevailed in some of the countries in the subregion over the last few years, much more needs to be done in terms of strengthening institutions to promote good corporate governance and to create the enabling environment, policy and legal framework to support implementation of sound corporate practice. In the region, several countries are engaged in this process, particularly Cameroon and Rwanda.

West Africa: The West African region has witnessed a raft of initiatives aimed at good governance, in addition to efforts at collaboration between civil law and common law jurisdictions through the various subregional agencies and common market institutions. Through the auspices of the West Africa Business Association (WABA), the entire region has achieved a high level of harmonization in the implementation of good corporate governance standards across the banking sector. Through OHADA (the Organization for the Harmonization of Business Law in Africa), the francophone countries of the region have developed comprehensive mechanisms for the harmonization of business laws and uniform accounting standards for SMEs.

North Africa: North Africa has also made good progress in implementing harmonized standards of corporate governance. This is particularly indicative of their work within the Middle East and North Africa (MENA) Corporate Governance Initiative which is supported by the OECD, CIPE, IFC, GCGF, and the World Bank.

2.3. Corporate Governance Developments at Country Level

An increasing number of countries in Africa are introducing various reform measures with corporate governance at the core. However, owing to a number of factors, the status of corporate governance reform in African countries is uneven, with varying levels of emphasis and effectiveness.

In this regard, African countries may be classified using the following framework according to their level of corporate governance reform:

Basic Compliance: In countries falling within this category, company law and regulatory frameworks exist but need to be upgraded. Governmental institutions are weak and the judiciary system and inspection organs are not properly staffed or empowered to perform their jobs. Firms largely ignore their corporate social responsibilities and NGOs (including requisite professional bodies) are nonexistent. In these countries, capital markets either do not exist or are very weak. These countries are usually targeted by development partners and receive a significant amount of concessional resources. Cooperation with other development partners is necessary to ensure that resources from any donor are matched with full and practical commitments from the government in order to develop and implement a more advanced corporate governance framework.

Intermediate Compliance: This category includes countries where company law and basic corporate social responsibility legislation are well established. However, compliance is mainly limited to large firms and medium enterprises. With few exceptions, small and very small entities are not compliant, particularly with regard to corporate social responsibility (CSR) rules. The capital market is small and stagnant. Specialized NGOs (such as accounting associations and Institutes of Directors (IoDs)) exist and are active.

Advanced Compliance: Countries in this category already have a good corporate governance framework, including relevant independent organs. However, they need to continually strengthen the independence of regulators, enforcement agencies, business and professional associations, and related institutions.

Post-conflict Countries (PCCs): In countries involved in peace building and post-conflict reconstruction, the emphasis is on rebuilding government institutions, stabilizing and rehabilitating the economy, as well as putting in place anti-corruption practices. In many of these countries, the existing legal and regulatory frameworks for company law and for corporate social responsibility have yet to be established, restored, and upgraded. PCCs lack relevant government institutions to develop such a framework and follow up with its enforcement. In these countries, the emphasis lies within a wider governance development effort to foster an enabling environment for future development of corporate governance.

The classification of countries provided above informs the Bank's strategy in terms of its actions at country levels, as presented in section 5 below[2].

2.4. Developments within Key Sectors

2.4.1. State-Owned Enterprises (SOEs)

The SOE sector in Africa continues to exert a significant impact on economic performance and on a wide range of stakeholders (e.g. governments, investors, financial markets, and the general public), particularly with the sector's domination of the key sectors of infrastructure provision and utility services (e.g. energy, transportation, gas, water, etc). The poor performance and failure of many SOEs in Africa can largely be ascribed to the prevalence of substandard levels of public governance.

Several African countries have undertaken measures to privatize, commercialize, and/or improve the performance of this sector. Some countries (among them Ghana, South Africa, and Kenya) have developed specific corporate governance guidelines for SOEs. Others have adapted or adopted certain modalities to implement the OECD or the Commonwealth Guidelines for the sector. The opportunity also exists for those in East, Central, and Southern Africa to use the generic framework on *"Governance in the Public Sector"* which has been developed by The Eastern, Central and Southern African Federation of Accountants (ECSAFA) as a basis on which to build national guidelines.

A number of other countries have put in place intensive regular reporting procedures for the SOEs by ensuring periodic accounts of their performance against negotiated targets. Increasingly, countries have also begun to adopt stringent selection processes for directors of SOEs to ensure that those appointed are properly qualified and fit persons to hold office and to safeguard transparency to shareholders.

2.4.2. The Banking Sector

Many of the countries in Africa have through the central banks adopted or adapted international guidelines which impact on corporate governance. These include the Basel I and II Guidelines, the Equatorial Principles, and the guidelines proposed by the Global Corporate Governance Forum (GCGF). In addition, nearly all central banks have issued prudential guidelines for commercial banks. Many central banks have also initiated training programs for bank directors.

It is recognized that the banking sector in Africa remains a key leverage point for mainstreaming corporate governance across respective sectors of the economy, particularly SMEs. Unfortunately the banking sector, particularly commercial banks, does not always play its full role in the development of corporate governance. In many African countries, access to financial resources is more closely linked to familial and social networks than to a firm compliance with basic corporate governance principles.

2.4.3. Capital Markets

Capital markets, which have played a key role in enhancing corporate governance in developing countries and in many emerging markets, are still mostly underdeveloped in Africa.

With the exception of very few countries, mainly South Africa and Egypt, African financial markets are still failing to attract global investors because of limited accessibility and exclusion from the main indices such as the Morgan Stanley Capital International Inc. (MSCI).

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2 See also Table 1 for a matrix of the Bank's proposed actions.

2.4.4. Small, Medium, and Micro Enterprises (SMMEs)

African economic activity is substantially conducted within informal networks. There is also the pervasiveness of small, medium and micro enterprises (SMMEs) which embody a number of problematics.

The continent's indigenous economic enterprises are affected by a number of crosscutting issues, such as: poor governance standards, inadequate human resources, weak regulations and supervision, limited products and services, and underdeveloped marketing, innovation, and branding. Other challenges include low capitalization and weak access to credit, poor information technology, and high taxation phobia, lack of financial standards, unsustainable business models, and HIV/AIDS.

Innovative solutions are required to mainstream corporate governance in SMMEs, particularly in terms of providing appropriate incentives for the informal sector to improve their corporate governance standards as well as their capacity to implement reform programs.

2.4.5. The Cooperatives Sector

Some countries have developed guidelines on corporate governance in the cooperatives sector, e.g. Kenya. However, the need for intensive training for cooperative directors is still a pressing issue.

2.5. Key Initiatives Supporting Corporate Governance in Africa

2.5.1. The institutional framework in support of corporate governance within Africa includes the following elements:

- *The New Partnership for Africa's Development (NEPAD) and its components*, e.g. African Peer Review Mechanism (APRM), NEPAD Business Group, and NEPAD Business Foundation.

- *Specific institutions*, e.g. UNECA, The Africa Capacity Building Foundation (ACBF), The Africa Governance Inventory (AGI) and African Stock Exchanges Association (ASEA) and AMSCO, which acts more than as a company.

- *Key continental initiatives* such as the Business Ethics Network-Africa (BEN-Africa), Business Action Against Corruption (BAAC), African Parliamentary Network Against Corruption (APNAC), and the Pan African Consultative Forum on Corporate Governance (PACFCG). While these initiatives are not institutions in the strict sense, nonetheless they play an important role.

- *African research and advocacy organizations*, e.g. The Africa Governance Monitoring and Advocacy Project (AfriMAP), African Institute of Corporate Citizenship (AICC), African Leadership and Progress Network (ALPN), and Centre for Corporate Governance of Nairobi (CCG).

- *Subregional organizations* have also been involved in promoting good corporate governance practices. These include the UNECA regional offices, Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), Eastern and Southern African Federation of Accountants (ECSAFA), Economic Community of West African States (ECOWAS), Middle East and North Africa (MENA) Corporate Governance Initiative, Southern Africa Development Community (SADC), SADC Development Finance Resource Centre (DFRC), West African Business Association (WABA), and the West African Economic and Monetary Union (WAEMU).

- *International development partners* cooperating to promote corporate governance reform in Africa include the Australian Africa Governance Program, US Center for International Private Enterprise (CIPE), Commonwealth Association for Corporate Governance (CACG), Department for International Development (DFID – UK), European Union, Global Corporate Governance Forum (GCGF), the World Bank and the International Finance Corporation (IFC), Organisation for Economic Cooperation and Development (OECD), Nordic Governance Program and the UN agencies (UNDP in particular).

- *Academic* networks such as CODESRIA and African universities are increasingly focusing on corporate governance, e.g. the University of South Africa Centre for Corporate Citizenship (UNISA CCC), Lagos Business School in Nigeria, DCDM Business School in Mauritius, University of Nairobi in Kenya, Gordon Institute of Business Science (University of Pretoria), and Graduate School of Business (University of Cape Town).

2.5.2. Other key initiatives and related guidelines that frame corporate governance reform include:

- *The OECD Guidelines for Multinationals* (including a risk management tool edition for those operating in weak governance zones); the Convention on Combating Bribery of Foreign Public Officials in international business transactions; and the Guidelines for SOEs.

- *The Equator Principles* led by the IFC, which provides a framework for financial institutions to manage environmental and social issues in project financing. The Equator Principles have so far been adopted by most of the world's major financial institutions.

- *The Global Reporting Initiative (GRI)* which provides voluntary guidelines for organizations to report on the economic, environmental, and social dimensions of their activities, products, and services.

- *The UN Global Compact*, which enjoins companies to embrace, support, and enact, within their sphere of influence, a set of core values in the areas of human rights, labor, the environment, and anti-corruption.

- *The Extractive Industries Transparency Initiative (EITI)*, which aims to increase transparency in transactions between governments and companies operating in the extractive sector, to ensure that revenues from such industries contribute to sustainable development and poverty reduction.

- *The Basel Committee Guidelines*, aimed at improving the quality of banking supervision.

- *The Financial Action Task Force (FATF):* Its recommendations have resulted in various national and international measures aiming at combating money laundering and terrorist financing.

- *The International Cooperative Alliance Guidelines* for the cooperatives sector.

3. THE BANK'S CORPORATE GOVERNANCE STRATEGY

3.1. Core Objectives: Four Guiding Principles

The Bank's strategy aims at promoting four key governance principles (transparency, responsibility, fairness, and accountability) at the corporate level and to ensure that the necessary regulatory framework and institutional capacity are in place to enforce them. These principles form the common basis of all internationally accepted corporate governance guidelines and codes. They also correspond to best corporate governance practice.

(i) **Transparency:** The need for transparency in all firms is critical to a corporation's growth. Transparency should apply to capital ownership, particularly in large and medium sized enterprises. Many firms are bound in webs where ultimate or beneficiary share ownership is concealed. Given that close-knit and highly concentrated business environments are not an exception, it follows that related party transactions, such as insider dealing, and conflicts of interests, nepotism or cronyism by directors, are likely to occur and may be difficult to identify. All firms, including small enterprises, must ensure that they are run in a transparent way to avoid any decision that may adversely affect employees, shareholders, and other stakeholders.[3]

(ii) **Responsibility:** This covers three different areas: (i) responsibility of board members and directors of large and medium size companies for the way firms are run; (ii) responsibility of managers before the board of directors; and (iii) responsibility of corporate leaders to comply with their basic social responsibility, in particular in relation to employees (safety, health and labor laws) and local communities (including respecting the environment).

Studies show that there is a significant degree of failure among key players (in particular directors) in understanding and observing these responsibilities. Consequently, Institutes of Directors (IoDs) have been established in many countries, as well as the provision of specific training by organizations such as the Commonwealth Association for Corporate Governance, CCG, AMSCO, and the Global Corporate Governance Forum. SME owners must bear the same responsibility to their employees, local communities, and customers as owners of large enterprises, although they are sometimes unaware of their legal obligations.

(iii) **Fairness:** The systems that exist within the company must be balanced in taking into account all those that have an interest in the organization and its future. The rights of various groups have to be acknowledged and respected. For example, minority shareowner interests must receive equal consideration to those of the dominant shareowner(s).

(iv) **Accountability:** This is the fourth pillar of good corporate governance. Large companies and their officers (at both management and board levels) must be accountable for the decisions and actions they take. Overall, boards are accountable by law to shareholders and subject to fines, criminal sanctions or removal for failure to comply with their responsibilities. In most cases, financial and non-financial reporting obligations are set out in the laws of countries; often they are in conformity with international standards. However, in many countries, a lack of compliance, timeliness, accuracy, and verification of such reporting remains a serious issue. Moreover, mechanisms for shareholders to uphold their rights to remove directors are often weak. In smaller companies, ownership tends to be concentrated among small groups of managers, friends, and family members. This increases the importance of social accountability for small enterprises.

3.2. Operational Objectives of the Corporate Governance Strategy

In order to safeguard these four guiding principles of transparency, responsibility, fairness, and accountability in RMCs, a number of objectives need to be set:

- Assist in establishing appropriate frameworks conducive to good governance and encourage the establishment of an integrated and coherent legislative and policy framework.

- Support the introduction of basic standards of corporate social responsibility as part of corporate governance legislation and regulation, in order to encourage firms to grow in a socially and environmentally responsible way.

- Increase awareness of the importance of good corporate governance among corporate stakeholders, in particular owners of very small and small enterprises.

- Promote corporate governance standards within SOEs, including during the process of privatization.

[3] For example, strict rules should be followed when selling a firm's assets, partially or in total, to avoid any breaches of conduct.

- Assist in broadening the understanding within the financial and banking sectors about the benefits of good corporate governance standards among target clients (large or small, public or private) in order to minimize the risk of investing and to maximize potential returns.

- Ensure that Bank-funded programs embody good corporate governance practices as a necessary development lever. The strategy will guide the Bank's future lending and assistance program, ensuring that corporate governance concerns and issues are fully taken into account in any region and country program, both at country and corporate levels.

3.3. Comparative Advantages of the Bank

The African character of the Bank and its long experience in dealing with governments and other key stakeholders places it in a strong position to improve the corporate governance framework of RMCs. The key strengths of the Bank are:

- Experience in encouraging reforms;

- Good knowledge of financial sector actors, particularly financial intermediaries;

- Good understanding of corporations from the private sector (including large enterprises) and SOEs across the continent;

- Significant experience in developing SMEs;

- Its standing in the international community as a good model in terms of corporate governance.

3.4. Components of the Bank's Strategy[4]

3.4.1. Standards and Norms Development

When a country is committed to improving its standards and norms in the form of a legal and regulatory framework, the Bank will assist, using dialogue and a participatory approach with all stakeholders as the major tool. It will conduct its work in liaison with other partners, in particular the NEPAD-APRM in the event that the country is part of this mechanism. Once laws have been adopted and the government has confirmed its commitment to their implementation, the Bank will assist regulatory bodies, business associations, and other local partners to develop specific codes, including codes of practice, codes of conduct, and codes of ethics, which will constitute the corporate governance framework of each concerned sector. This will be completed within the framework of a public-private partnership.

Special attention will be paid to small and very small enterprises. They often lack the administrative and managerial competencies to allow full corporate governance regulations to be applied. Therefore, a simpler set of standards should be derived from the corporate governance codes to better suit enterprises in these categories. However, rules such as ethical norms and standards of environmental protection should apply to all firms, whether they are micro, small, medium or large.

The Bank will give priority to partnership in assisting countries to develop such standards and norms and related codes. It will strengthen the capacity of existing institutions such as CCG, AMSCO, and ECSAFA, as well as cooperate with institutions such as IFC/GCGF and corporations such as ESKOM (South Africa) who are well advanced in addressing corporate governance issues.

[4] These components will build together into different action plans to develop the corporate governance capacity for each country where the strategy is applied. Standards and norms should be developed while taking into account the existing international guidelines, which have already been adopted by the NEPAD Heads of State and Government and which guide the APRM activities. For historical reasons, international standards have mainly been developed for large firms. However, they are governed by principles that apply to SMEs as well as very small entities.

3.4.2. Institutional and Human Capacity Building for Law Enforcement

African institutions that deal with corporate governance frequently encounter firms and policymakers who lack a clear understanding of the complexity of issues and who have neither the resources nor the capacity to implement and enforce related rules. Governments, regulators, ratings agencies, NGOs, banks, and other financial institutions may all require assistance in this way. The Bank is in a strong position to assist stakeholders within RMCs to improve the institutional and human capacity for mainstreaming corporate governance. The Bank will provide technical assistance to these stakeholders. It will utilize existing centers of knowledge and excellence and available competencies in RMCs (including large African corporations) to achieve this objective.

At a human capacity level, Bank action will involve the provision of training for stakeholders or counterparts to help them to properly execute their functions. Institutions and regulators such as EPAs, SECs, and IoDs will be assisted to develop their own strategies and policies to make them more effective.

Within the context of building capacity, the Bank will aim to raise awareness among stakeholders of the importance of implementing and complying with corporate governance principles. Case studies of success stories will be disseminated as part of raising awareness and capacity-building programs.

Financial Support

The Bank will extend its financial support to countries as well as selected firms and financial intermediaries to improve the corporate governance status of its RMCs.

Policy-Based Lending

Policy based loans (PBL) will be the first instrument to assist countries where there is a basic compliance with corporate governance principles. This lending instrument will also be extended to countries in post-conflict reconstruction.

Lending will be targeted at governments that have committed to reform their corporate governance systems and who wish to develop their corporate governance framework and institutions. PBL will be used as an instrument to encourage countries to upgrade their existing legal regulatory framework, and benchmarks will be introduced accordingly.

The first compliance area to be reviewed will concern procurement and tendering in respect of public works and services. Governmental services should have the capacity to ensure compliance of bidders with basic corporate governance principles.

Financial Support to Corporations

In addition to supporting governments to improve corporate governance, the Bank will use its resources to support corporations, including banks and financial institutions, who demonstrate a firm commitment to improving their practices. The Bank will provide them with favorable conditions for access to its resources.

With respect to financial intermediaries, the Bank will place conditions on the resources made available to them by linking this to compliance with corporate governance principles. [5]

The aim of providing targeted support to corporations, including financial intermediaries, in this way is twofold. First, it will encourage firms to adopt good corporate governance practices. Second, it will facilitate benchmarking and the recognition of best practices and role models within countries and sectors.

[5] Specific agreements linking conditions under which these “champions” of good governance will have access to Bank resources will be designed to ensure proper implementation of this initiative and prevent any significant market distortion. Measures to make better use of stock markets in promoting corporate governance will also be explored.

4. OPERATIONALIZING THE STRATEGY

4.1. Guiding Principles for Implementing the Strategy

In implementing the strategy, special attention will be paid to existing or projected assistance programs developed by other partners. The following principles will guide the design of country-specific programs:

Ownership

The strategy aims to help stakeholders (governments, business community, financial intermediaries, etc.) in RMCs to develop mechanisms and adopt programs of action that will strengthen corporate governance. This implies not only endorsement of the strategy by the stakeholders, but also their full participation in designing country programs. Therefore, the Bank will actively promote consultations and the full involvement of all concerned stakeholders. Wherever possible, it will use IFC as a platform.

Complementarities

In order to ensure that the strategy is efficiently implemented and to avoid duplication of efforts, the Bank will build on strategic partnerships with other key regional and international players, particularly NEPAD-APRM.

The Bank's strategy will complement existing efforts and focus on areas that are not already covered. In designing plans of action, the Bank will prioritize areas in which it has a competitive advantage and can add the most value. To this end, the Bank will focus on actions that are most likely to bring about noticeable corporate governance performance improvements for selected RMCs.

The Bank will not intervene in areas already covered by other corporate governance development programs and those in which governments could easily implement national programs, except when its intervention would increase the effectiveness of other existing programs.

The Bank will ensure that its actions strengthen and make the best use of existing frameworks and institutions (such as OHADA).

Selectivity

At the country level, the Bank's strategy will focus on countries and institutions that demonstrate a strong commitment to the reform process.

At the corporate level, the best performers will benefit from favorable conditions in accessing ADB's resources. The Bank will examine the possibility of providing specific assistance and increasing facilities to borrowers that demonstrate significant progress in complying with good corporate governance principles, particularly among SMEs. In addition, it will assist financial intermediaries to offer better conditions to small and very small enterprises that are actively engage with good corporate governance principles.

Flexibility

Corporate governance principles are largely translated in a series of international standards, norms, and codes of practice. However, their implementation may vary, depending on the size, location, and circumstances of the business. This strategy seeks to encourage countries to adapt the existing standards and norms to their specific context. It will also develop incentives for corporate entities to adopt and follow them. The bulk of existing work focuses on the governance of large and publicly listed companies. This strategy encourages countries to develop specific codes of practice for SMMEs with simple and non-intrusive procedures.

Regional and Country Perspectives

Where feasible, the Bank will promote actions and programs that are regionally designed and oriented.

The Bank will assist countries using regional mechanisms (such as OHADA) and institutions (such as CCG, ECSAFA, and AMSCO) to improve their corporate governance practices. It will encourage countries to adopt and adapt existing instruments and codes rather than developing new ones.

4.2. Priority Focus for the Bank's Intervention

The Bank's efforts to improve corporate governance will target three key players: (i) government organizations and regional institutions, including regional economic communities (RECs); (ii) financial intermediaries; and (iii) corporations, particularly SOEs and SMEs.

5. BANK ACTION AT THE COUNTRY LEVEL

5.1. Basic Compliance with Corporate Governance

The strategy in respect of RMCs within this category will be to improve existing corporate governance frameworks and levels of overall compliance. This activity will be conducted within the context of political and economic governance programs and will focus on strengthening company laws and developing capacity for enforcement. This will include formulating a legislative framework for corporate social responsibility, such as health and safety law, and environmental standards. The Bank will also use its policy-based lending instrument to build capacity in specific sectors where a lack of expertise is impeding progress, such as the judiciary.

The Bank will assist individual firms to develop best practice in corporate governance by affording them more favorable terms for access to its resources. In addition, the Bank will assist financial institutions toward the adoption of corporate governance principles by their clients as a condition for financial support. The Bank will use these institutions to disseminate and promote the adoption of corporate governance principles, especially among SMEs, by linking transactions (loans etc.) to such principles.

The overall aim is to establish or develop the basic institutions that foster good governance principles, and to establish or enhance the capacity of governments to enforce adopted codes of conduct. Actions will be tailored to the individual set of circumstances, as conditions vary widely between RMCs within this category. The following are the key actions to be initiated for the basic compliance category:

Improve Company Law: The most basic element of a corporate governance framework is the company law within which firms operate. The Bank will provide technical and financial support to strengthen the essential legal framework.

Strengthen Accounting Standards: Fundamental to transparent, responsible and accountable corporate governance is a strong adherence to well-defined accounting standards. The main failures relating to the way in which companies are run are, in essence, failures in accounting, reporting obligations, and controls. The Bank will support governments, in partnership with professional accountancy organizations, by providing technical support to adopt and adapt international accountancy standards within the country's legal framework. Institutions such as ECSAFA will be encouraged to play an active role in this area.

Introduce Corporate Social Responsibility (CSR): The Bank will offer technical advice to governments to develop legislation that will provide a basic framework for corporate social responsibility and the protection of environmental standards. Typically this will involve health and safety legislation and environmental protection legislation. The Bank's support will ensure that the legislation and regulations put in place are realistic and do not detract from the fundamental CSR objectives (for example, to make corporation's growth sustainable, for the benefit of its shareholders, the wider community, and the region in which it operates).

Develop Regulatory Bodies: The Bank will help to establish or develop the key regulatory institutions necessary for the proper observance of basic corporate governance principles. It will provide technical support to develop institutions such as an Audit Commission, and professional associations such as Institutes of Chartered Accountants, and auditors' and lawyers' associations. Organizations will be encouraged to develop and adopt their own codes relating to corporate governance (such as a code of ethics) to regulate the governance of their business.

Enhance Enforcement Capacity: The major difficulty faced by many RMCs when developing their corporate governance standards is that of enforcement. Companies are reluctant to comply with corporate governance regulations as they are perceived as disadvantageous to them, at least in the short term. The Bank will assist RMCs, through policy-based lending and technical assistance programs, to strengthen capacity of enforcement agencies. This support will take the form of human capacity building programs (e.g. training police officers and judges); institutional capacity (strengthening investigative agencies); and raising awareness among stakeholders of the existence of the new laws. The aim will be to ensure that the government is capable of compelling companies, especially larger companies, to comply with basic corporate governance standards.

Encourage Company Registration: Companies that operate in the informal sector are much harder to regulate with respect to their observance of corporate governance and corporate social responsibility practices. However, ultimately they are at a disadvantage because they face far greater obstacles in accessing finance or garnering support from capacity-building institutions. The Bank will provide assistance for sensitization programs that highlight the advantages of company registration in RMCs. Technical assistance will be part of any program, to build the capacity of the government to encourage company registration, by developing a simplified registration process and simplified reporting requirements for small firms.

Educate Stakeholders: New developments in the corporate governance framework will need to be explained to the key stakeholders and to the public at large, especially once the government actively begins to enforce it. The Bank will assist governments and specialized bodies to develop programs to raise awareness.

The Bank will also consider providing preferred terms and conditions for its financial support, including awarding an interest rate bonus to financial entities and corporations who comply with good corporate governance principles. This will encourage them to act as "champions" of good corporate practice in their respective sectors of intervention.

5.2. Intermediate Compliance with Corporate Governance

The overall objective of the Bank's strategy for countries with an intermediate level of corporate governance is (i) to consolidate the existing corporate governance practices, and develop new ones; (ii) to build on existing standards (including social and environmental) and expand them into an enhanced framework; and (iii) to strengthen corporate governance institutions such as ratings agencies. In these countries, many small enterprises and very small businesses fall through the compliance net and specific actions need to be designed and conducted to prevent this.

The Bank will use its policy-based lending programs to:

- Assist governments to develop their corporate governance framework;
- Build internal human and institutional capacity to continually improve company law, develop or strengthen capital market law, and develop or strengthen corporate social responsibility legislation;
- Help develop the capacity of specialized institutions to enhance their enforcement capacity, including environmental protection agencies;
- Develop awareness programs targeting key stakeholders; particularly SMMEs.

In parallel, the Bank will target banks and financial institutions to act as agents in promoting best practices among small and very small companies.

Specific actions will include:

Develop Capital Markets: The development of capital markets as a catalyst for improving corporate governance is a well-established principle in the developed economies. For many countries in this category, a capital market exists. The Bank will provide support to strengthen the institutional capacity of these organizations in order to provide facilities for SMEs to raise capital and locate investors. In order to ensure that these investments are safe, the Bank will also support the development of capital market codes of conduct for listed firms; and regulatory bodies such as securities and exchange commissions.

Develop Ratings Agencies: The development of ratings agencies has two key benefits. First, they allow investors to gain a better understanding of the companies listed on the capital markets and, second, they are very important to lending institutions when assessing the potential risks of funded operations. The Bank will provide financial support and technical assistance to build institutional capacity for such agencies. This will in turn help larger SMEs to access financial resources under more favorable conditions.

Assistance in Developing Legislative Frameworks: With the expansion of capital markets, countries may require a strengthening of their corporate governance legislative frameworks. The Bank will assist in developing this framework by providing technical assistance to ensure that areas such as the role of the board, auditing, and insider dealing are properly covered, in full compliance with international standards. This will also include strengthening the corporate social responsibility legislation.

Develop Specialized Non-Government Organizations: Depending on the existing situation in the country, the Bank will offer support and technical assistance to strengthen the institutional framework for corporate governance. This will include supporting NGOs such as IoDs, Institutes of Chartered Accountants, and lawyers' associations. The Bank can support their development and also their communication work by recognizing them as important stakeholders, engaging in dialogue with them, and facilitating communication between the different parties. In eligible countries the Bank may also provide direct financial assistance if required.

Educate Key Stakeholders: SMMEs' non-compliance with corporate governance principles is due to two key factors: a lack of awareness of the principles among owners and managers of SMMEs and a lack of incentive to comply. The Bank will therefore seek to support countries to develop awareness programs, which specifically target SMME stakeholders (in particular through the media or through a series of road shows and workshops). These actions will complement Bank efforts to strengthen the role of regional banks and local financial institutions as corporate governance agents. Other Bank programs which specifically target SMEs, such as the Franchising Initiative and the Growth-Oriented Women Entrepreneurs (GOWE) program will also include such activities.

5.3. Advanced Compliance with Corporate Governance

Countries in this "advanced compliance" category already have a good corporate governance framework, including relevant independent organs. However, there is a need to continually strengthen the independence of regulators, enforcement agencies, business and professional associations, and related institutions.

Currently only a very small number of countries in Africa would qualify for inclusion in this category, and these countries should be seen as beacons for the rest of the continent. They should be encouraged to extend assistance and share best practices with other countries.

For this advanced category of compliance, Bank assistance will consist of advancing corporate governance standards, through the adjustment of internal codes to international best practices, particularly in the area of corporate social responsibility and SOE management. Banks and financial institutions may require support in building human and institutional capacity in order to exercise due diligence to potential small firm clients. Support would be extended to encourage them to follow the codes of corporate governance to which they are committed.

Actions will include:

Enhance Ratings Agencies and Institutions: The final stage of the Bank's program to develop the institutional framework in RMCs will be to ensure that institutions (including ratings agencies, government agencies, and NGOs) are independent of any undue influence from powerful lobbies so that their integrity can be assured. Any remaining ties to individual corporate entities and any government interference would seriously weaken their ability to enforce corporate governance. For example, the Environment Protection Agencies (EPAs) must be able to penalize SOEs that cause pollution, and ratings agencies must be able to give poor ratings, even to large and powerful firms. The Bank will provide support through both policy-based lending and direct support as appropriate to build this independence.

Strengthen Banks' and Financial Institutions' Capacity: As an increasing number of firms comply with standards of corporate governance, especially transparency, banks and financial institutions will need to exercise due diligence over their investments. The Bank will help financial institutions to strengthen their capacity to undertake this task.

Broaden Share Ownership: With fair capital markets in place, the Bank is well placed to assist RMCs to broaden share ownership by helping to design awareness-raising programs through the media or through local communities.

Enhance Corporate Social Responsibility Standards: Continuously evolving environmental standards and international treaties require governments to be able to extend their corporate governance framework. The Bank (through JAI and other specialized institutions) will assist countries through specific training programs.

Empower Disadvantaged Social Groups: Recent developments in South Africa have demonstrated how corporate social responsibility can be used to empower previously disadvantaged people. The Bank will support the development of such programs.

5.4. Post-Conflict Countries

To impact on corporate governance in countries in the PCC category, the first objective of the Bank will be to assist in developing a legal and regulatory framework, as part of the overall governance program.

Actions will include:

Build Global Consensus for Corporate Governance: Through the broader political and economic governance programs, the Bank will support governments, together with existing stakeholder organizations such as business groups, to understand issues surrounding the required institutional framework (such as legislative capacity). The aim will be to establish the basic corporate governance framework and to build a commitment among the stakeholders to reform. Two major tasks will be conducted: (i) raising awareness of corporate governance issues among policymakers, and (ii) assisting countries to adopt company law and to develop related monitoring institutions.

Improved Lending Conditions for "Model" Firms: In post-conflict countries, operations without sovereign guarantee are usually considered very risky. The Bank will provide direct support to firms, through favorable lending conditions, provided they are committed to play the role of "champions" of good corporate governance practice.

5.5. Preconditions for Implementation

The first phase in designing any country plan of action will consist of an assessment of existing corporate governance standards and practices. The Bank is producing a number of reports to assist in this process.[6] They include the Country Governance Profile (CGP) and the Private Sector Country Profile (PSCP). These will be complemented with existing surveys and reports produced by other partners and specialized institutions.[7] In all cases, Country Strategy Papers (CSPs) will provide an overview of the status of corporate governance. This assessment will help classify countries in terms of existing standards of corporate governance; and identify priority areas for Bank intervention.

In implementing the strategy, the Bank will work closely with regional bodies and entities, including REC, to promote and support good corporate governance practices. Wherever possible, a regional approach will prevail in establishing adequate legal and regulatory framework and related corporate governance monitoring institutions; and in the adoption of accounting standards and codes of ethics and conduct.

5.6. Table 1 below presents the country categorization and actions needed for each category.

[6] For countries falling under category 1 & 4 (basic compliance and post-conflict countries), the assessments will be mainly part of the Country Governance Profiles. For the other countries, they will form part of the Private Sector Country Profiles.

[7] Several partners such as NEPAD and the World Bank Group are producing surveys that include information on corporate governance status.

Table 1: Country Compliance Classification for Corporate Governance

	Level of Compliance with Corporate Governance Principles	Characteristics	Dominant Practices	Required Actions
1	Basic Compliance	• Company law and regulatory framework are weak and largely ignored. • Very weak governmental institutions (judicial, inspection, etc.). • Weak government institutions in the area of CSR (health, environment, labor standards). • Nonexistence of NGOs or very limited role of those that do exist. • Capital market is nonexistent or weak.	• Government is committed to economic reforms. • No enforcement of corporate governance principles. • Some large firms follow principles of accountability, responsibility and transparency, but not to international standards. • Very few domestic SMEs conduct transactions in a transparent or accountable way. • Widespread governance concerns such as corruption. • Widespread tax evasion. • Little respect for basic CSR such as health and safety, and environmental protection. • Central bank does not impose on local financial intermediaries to conduct a due diligence exercise on their clients. • Local financial intermediaries do not integrate corporate governance principles in their due diligence exercise.	• Support sector reforms, in particular in the judiciary and financial areas. • Support strengthening company law (including CSR). • Support development of government awareness and enforcement capacities. • Support adoption of accounting standards. • Support financial intermediaries to become agents in promoting good CG practices. • Provide support to business associations to act as promoting agencies and early warning partners in the area of CG practices. • Develop strong cooperation with other partners to ensure that there is a common and strong link between access to financial resources and full implementation of clauses relevant to CG.
2	Intermediate Compliance	• Legal and regulatory framework is in force (company registration is well-established). • Basic CSR legislation (e.g. health and safety legislation) exists. • Enforcement of CG framework is limited to larger companies. • Capital market small and stagnant. • Active NGOs in the field.	• Governments actively pursue sector reforms. • Many large firms compliant with CG principles. • Banking and financial sector expect CG standards to be partially observed when providing resources to firms, including larger SMEs. • Governmental institutions in charge of CG are operational for larger firms and in urban areas. • Few SMEs are compliant; mainly those who are exposed to international markets. • Tax evasion only among smaller SMEs. • Smaller SMEs and very small firms are frequently noncompliant with CG including CSR principles.	• Strengthen existing legal and regulatory framework, including capital market law. • Strengthen technical skills of specialized government bodies and agencies. • Assist NGOs to better promote and enforce sector codes of ethics and conduct, in particular among SMEs. • Encourage financial intermediaries to act as agents in promoting CG best practices.

	Level of Compliance with Corporate Governance Principles	Characteristics	Dominant Practices	Required Actions
3	Advanced Compliance	• Company law is in force. • A functioning capital market exists with associated institutions such as SEC. • Strong NGO institutions such as Institutes of Directors are in place. • Business associations enforce codes of ethics. • The majority of corporate governance standards are observed. • Accounting professions are strong and independent with codes of conduct.	• Large firms are compliant with corporate governance standards. • CSR principles such as health and safety and environmental standards are widely adopted. • Banks and financial institutions enforce due diligence in corporate governance standards to clients. • Larger SMEs are compliant with corporate governance standards and use triple bottom line accounting methods. • Smaller SMEs are also compliant with some of the basic principles.	• Assist advancing corporate governance standards (upgrading existing codes and regulations to align them with best international practices). • Strengthen the capacity of banks and other financial intermediaries to deal with small and very small businesses. • Enlarge the benefits of CG to small business entities through specific programs (such as franchising, leasing, mutual guarantee mechanisms, etc.).
4	Post-conflict Countries	• No relevant legal and regulatory framework of company law. • No legal and regulatory framework establishing CSR. • No relevant governmental institutions. • No NGOs dealing with corporate governance.	• Weak governmental institutions. • Almost all firms are noncompliant with corporate governance principles.	• Assist in developing legal and regulatory framework (including company law). • Assist in establishing monitoring institutions. • Assist in raising awareness among key stakeholders. • Support best firms to act as “beacons”.

6. BANK'S ACTIONS AT CORPORATE LEVEL

Companies of different sizes and different ownership structures have different corporate governance needs and will require different corporate governance plans of action. In developed countries, public limited companies (PLCs) are common, a large numbers of SMEs are market listed, and very small enterprises (VSEs) are usually registered as limited companies in order to protect the owners against personal losses incurred by firms. This, however, is not the case in Africa. In RMCs, micro, very small and small enterprises are dominant with a large number not registered. Moreover, in most African countries, SOEs are still important, both in terms of size and economic and social role.

The Bank's strategy will therefore be tailored to suit the needs of the different types of organization/firm, as detailed below.

6.1. State-owned Enterprises and Firms in the Process of Privatization

State-owned enterprises are companies in which the government holds most or all of the shares. They are usually characterized as large and suffering from reduced efficiency. In many countries, a large proportion of them is loss-making and is subsidized by the state. SOEs present a different set of corporate governance problems. Most of them have blurred lines of authority with management being responsible both to ministers and to boards of directors. They therefore suffer from political interference at both directorial and managerial levels.

Since the 1990s, plans to restructure SOEs have been implemented in most countries. However, to date, states still control large portions of these companies and often remain a major investor/shareholder, even in privatized companies. This has presented a unique set of challenges, including the need to establish independent directors, to restructure in a socially responsible way, and to change the culture of the firm to one of accountability and transparency.

As SOEs represent an important part of the African economy, they would benefit greatly from improvements in their accountability and compliance with corporate governance principles. Large SOEs are often targets for government corruption, worsening the situation of global governance. They will be encouraged to adopt the OECD principles and guidelines.

Before and during the privatization process, openness and transparency are vital if the process is to be successfully concluded. Risk-averse investors will be more inclined to invest in businesses if they can gain access to all the important financial and corporate information and if the privatization process is open, fair, and free from political interference.

ADB is in a strong position to facilitate improvements in this area by providing important technical assistance and advice. SOEs are often poorly managed and require a great deal of both awareness-raising and capacity-building. A well-thought out and well-managed privatization program contains all the elements of good governance, namely, transparency, accountability, fairness, and responsibility. The Bank will develop these aspects of corporate governance for SOEs, both in the case of those in the process of privatization and those intending to remain in the public sector. The Bank will help to build capacity within firms at board and managerial level to take direct control over the decision-making process by engaging existing institutions such as IoDs. This will be part of either its program of assistance to the country, or part of its lending program to publicly guaranteed entities. Compliance with corporate governance standards will be a condition to access non-sovereign guaranteed financial support. The Bank will use the existing initiatives and programs, and will collaborate with institutions, such as AMSCO, ECSAFA, CCG and the GCGF to improve SOEs' standards.

6.2. Small and Medium-Sized Enterprises

Small and medium enterprises (SMEs) constitute the bulk of the firms in Africa. There is huge variation in the behavior and characteristics of these firms. The makeup of SMEs varies in terms of size, structure and ownership. Most of them (over 90%) are family owned or single proprietorships; they have tight controls put in place by the owner, and often delegate managerial roles to close relatives. Yet SMEs, particularly the smaller ones, often lack transparency and frequently do not disclose financial and tax information. Their knowledge of proper accounting procedures, accountability, and responsibility is very limited.

Corporate governance is both relevant and critical to the growth of SMEs in Africa. Current efforts at propagating corporate governance focus mainly on large publicly traded and multinational institutions, and do not pay particular attention to the needs of SMEs.

The Bank has demonstrated a strong commitment to supporting the growth and development of the SME sector, and is systematically stepping up its efforts in institutional capacity building and direct funding support. In line with these initiatives, the Bank will spearhead a corporate governance agenda aimed at this critical sector, supporting activities to build institutional and human capacity, to raise finance and support initiatives for its development.

Small firms will be assisted directly by the Bank under specific programs (such as the Franchising Initiative and GOWE programs) which provide improved lending terms and conditions based upon a firm acceptance and adoption of good corporate governance principles. This will have the additional benefit of creating ”champion” firms that will act as models of good corporate governance for others to follow. Furthermore, the Bank will provide direct technical advice to build the human capacity of owners of firms, for instance by offering training in running and managing companies, using the existing facilities, such as AMSCO and PEP Africa.

Significant impact can be achieved in this field through indirectly supporting firms. The key channels are:

- Policy-based lending to governments to develop and strengthen the institutional framework for the SME sector, for instance by developing simplified company registration and accounting procedures for small firms; and

- Initiatives that help small firms to compete in the marketplace, for example by assisting them to form cooperatives and mutual organizations to negotiate with suppliers, access foreign markets, and deal with financial intermediaries.

- Further indirect assistance can be provided through empowering banks and financial institutions to act as corporate governance ”guardians”, ensuring that the businesses they invest in are properly run.

6.3. Very Small Enterprises (VSEs) and Micro Enterprises

Very small and micro enterprises could be considered as a subset of SMME sector in terms of their size. However, they need to be given special recognition because of the extra practical difficulties of applying corporate governance standards, both for the trader and the enforcement agency.

The smallest enterprises are usually sole traders, or very small groups including many family-owned businesses. As with SMEs generally, VSEs are broad in scope. These companies are often not registered as legal entities and their owners are exposed to unlimited liabilities. Such companies often operate in the informal sector and can experience severe difficulties securing even basic financial and banking services.

In the case of VSEs, the Bank will improve the governance of financial and technical institutions that work directly with very small businesses in order to give them greater access to business support services and finance. Indirect support will be ensured by strengthening banks and financial institutions, especially microfinance institutions, in the same way as for SMEs. Microfinance programs supported by the Bank will systematically address the need to strengthen compliance with corporate governance principles among beneficiaries. They will build on ongoing initiatives such as those being developed in countries like Mali, which offer specific incentives to encourage business registration and compliance with basic good governance principles.

6.4. Cooperatives

Cooperatives and producers’ associations are also an important framework in promoting good governance. Difficulties that many face, with direct consequences on their members’ revenues, are often linked to their poor compliance with good corporate governance practices and guidelines. It is therefore important for the Bank to ensure that this dimension is fully reflected in its programs that target producers’ associations, particularly in rural areas.

6.5. Financial Institutions

The financial sector includes state-owned and privately owned banks and other financial institutions such as insurance companies. In corporate governance terms, they are bound by the same standards of corporate governance as large firms and SOEs; and they must have responsible directors and behave in an open and transparent manner.

Africa's businesses will continue to rely mainly on debt financing for their growth and development. Yet, this crucial banking sector has been plagued by some of the largest scandals, with fraudulent deals exposed within the public and private sectors of several countries. Several countries in Africa still have some way to go in implementing efficient and effective banking supervision in line with the standards set by the Bank of International Settlements. Central banks must lead good corporate governance compliance by enforcing standards in the banking sector. They should be mandated to demonstrate the highest levels of good corporate governance in all the main areas, with little room left for discretion. Stringent best corporate practice is not restricted to the central bank and commercial banks; it should apply to all institutions that are custodians of public funds, be they national social security funds, microfinancing institutions, investment banks, insurance companies, or brokers.

The Bank is currently entrusted with the financial standards endorsed by NEPAD. In cooperation with the IMF, which is playing a leading role in supporting central banks and the financial sector worldwide, the ADB will play a significant role in supporting the promotion of good corporate governance practices among banks, other financial institutions (especially microfinancing institutions) and other bodies that lie outside the core of central bank supervision, such as DFIs.

The Bank will make the adoption of a strong and well-observed code of corporate governance, together with a strong code of ethics, a condition for financial support to financial institutions.

One of the key strategic actions will consist of strengthening the capacity of second-tier banks to enforce standards of governance among client firms. In this way these banks will act both as agents disseminating the codes, and as enforcers, ensuring that they are adhered to.

Financial institutions, in particular microfinancing institutions, will be supported to develop governance criteria as part of their lending policies. In this way, banks and financial institutions, including microfinance organizations, can act as agents, disseminating good corporate principles to their clients.

Microfinance institutions will receive special attention, because of their role in entrepreneurship development in local communities and among disadvantaged populations. Microfinance institutions vary greatly in size but are often characterized as small companies. They supply financial services to small businesses and individuals in poorer areas where large banks are unwilling to operate, given the perceived risks, high cost of small transactions and a lack of collateral. Corporate governance is essential to microfinance institutions because of their limited assets and capital-base, and the profile of their clients.

In order to disseminate corporate governance principles effectively, the Bank will involve regional DFIs, local financial institutions, and microfinance organizations in its programs. The Bank will use its close existing relationships to raise awareness of the need for good corporate governance among client firms which local financial institutions support. This will ensure that compliance with corporate governance principles is strengthened while also reducing the risk to banks of supporting African businesses. The JAI will be called upon to organize workshops, on an annual basis, to assist in this venture.

7. PARTNERING TOWARD IMPLEMENTING THE STRATEGY

7.1. Engaging with Other Partners

The Bank has been requested by the NEPAD Heads of State and Government to take the lead in the area of corporate governance. It will therefore give priority to regions and countries that have agreed to be assessed by the APRM. It will closely work with involved institutions under this mechanism, in particular with the UNECA, the PACFCG, GCGF Commonwealth Secretariat, and the IFC in order to avoid duplication of efforts.

Many of Africa's regional institutions aim to promote private sector development and can provide a framework for the Bank to reach wide sections of Africa's business community. They include the African Business Roundtable, the NEPAD Business Summit, and institutions such as the African Institute of Corporate Citizenship and AMSCO. This extra reach will allow the Bank to spread the benefits of its Corporate Governance Strategy widely and cost-effectively.

The Bank intends to work in partnership with concerned institutions in order to develop frameworks of corporate governance standards for use within regional organizations based on the principles adopted in this strategy. These would then be used for externally partnered programs, such as the African Growth and Opportunity Act (AGOA) and the EU-MEDA program. The COMESA Treaty, for example, does not explicitly contain corporate governance guidelines for its members. However, it is committed to creating an enabling environment and a legal framework that will encourage the growth of the private sector, the establishment of a secure investment environment, and the adoption of common sets of standards. COMESA will therefore provide a suitable institutional framework for establishing and monitoring cross-country corporate governance benchmarks. Furthermore, COMESA's intention to harmonize macro-economic, monetary and industrial policies throughout the region makes it a suitable forum for setting regulatory and compliance standards, where these are deemed necessary. SADC, ECOWAS, and WAEMU also provide a sound platform from which to develop corporate governance programs in those regions.

7.2. Existing Programs

Existing programs provide a good basis for corporate governance developments on the continent. However, they leave important gaps in which the Bank can deploy itself. Shortcomings in the existing programs include:

- A noticeable lack of support for SMMEs;
- No attempt to use banks and financial institutions as agents to disseminate good corporate governance, in particular to smaller firms;
- Insufficient efforts directed at developing corporate governance among countries and firms where the principles are not already established, rather than improving existing committed ones;
- Lack of incentives for firms to engage in good corporate governance, for instance by providing companies with favorable tied lending conditions; and
- Insufficient work directed at developing corporate governance in SOEs[8] and firms entering the privatization process.

[8] OECD have recently developed specific guidelines for SOEs

8. CONCLUSIONS

The two main objectives of the Bank's Corporate Governance Strategy are :

- To assist RMCs in improving/reforming the corporate governance institutional, legal and regulatory environment, in line with international codes and best practices; and

- To assist firms and financial institutions to adopt and comply with these codes.

This constitutes an integral "bottom up" approach which will be implemented in consultation with other regional partners already active in the area of corporate governance, in particular NEPAD.

The Bank will develop dialogue with relevant stakeholders, such as members of government and members of the business community, in order to begin the process of raising awareness of the importance or corporate governance for the economic development of the country, thereby fostering a commitment to future reforms.

Many countries in Africa have not officially adopted a set of corporate governance standards, and fewer have properly adapted this into codes of practice, conduct, and ethics. The Bank will extend its technical assistance to targeted stakeholders within RMCs to develop a code of corporate governance based on international standards; and to adapt this code to reflect the particular circumstances of each country. A commitment by stakeholders to this code will be a prerequisite for any future assistance by the Bank to that RMC.

In order to encourage changes in individual firms within RMCs, incentives will be offered to enhance their standards of corporate governance. The Bank will offer improved access to its resources, such as favorable interest rates, for firms that can demonstrate and are ready to champion good corporate governance principles. This is a reflection of the Bank's commitment to raise corporate governance standards, and an acknowledgement that firms that demonstrate a commitment to transparency, accountability, and responsibility present a lower level of risk than those that do not. Firms receiving assistance from the Bank on these terms will then act as models of best corporate practice within their communities.

The Corporate Governance Strategy is an important component of the Bank's overall governance strategy. It represents a way for the Bank to enhance economic and political governance in African countries by promoting good practice at corporate level. This bottom-up approach will complement other Bank policies and programs aiming at promoting governance, making African economies strong and attractive to investors both local and foreign. The strategy will also allow the Bank to enlarge its support to private sector, thus contributing to sustained growth in the continent and so helping to reduce poverty.

Operational directives will be issued to guide Bank's future operations, particularly non-sovereign guaranteed operations and PBL. In parallel, pilot projects will be initiated for selected countries, in close collaboration with regional and local institutions.