Making a Case for an OHADA Corporate Governance Principles-Based Regime

Enga Kameni[*]

A. Introduction

The demands for corporate sanity and probity have increased tremendously in recent years, especially in the aftermath of the Enron Scandal, whose impacts were so profound that it ushered in a wave of corporate and securities law reforms both in the US and globally. International organizations, civil society organizations, financial institutions, multinational corporations, business men and scholars have joined the bandwagon by being unanimous in their clarion call for more accountability and transparency in the ways companies are managed. Aside the Enron Scandal which exposed managerial frailties, such clarion call might have also been largely influenced by the view that the way a company is managed might reflect to a certain extent the way it does business. Hence an assumption that bad management would not only be detrimental to the shareholders who have invested their fortunes in the company, but might have long-term ramifications on local communities in particular and to the host country in general. For instance, the company might go bankrupt and current investors might pull out, thereby creating unemployment and sending a very bad impression to prospective investors contemplating business ventures in such a host country. The answer to these uncertainties has been the emergence of corporate governance codes and/or pieces of legislation with the Sarbanes Oxley Act of the US, being one of the oft-cited examples.

As mentioned above, the past few years have witnessed a mad rush in legislative activism by many countries taking the form of the enactment of pieces of legislation on corporate governance. Some African countries have joined the bandwagon. For instance, African countries that are part of the Organization for the Harmonization of Business Laws in Africa (OHADA) Treaty, an initiative aim at streamlining, reforming and harmonizing business laws in Africa, have not been left out. They are all signatories to the OHADA Uniform Act on Commercial Companies and General Interests Groups which contains a couple of corporate governance provisions. This is a very welcoming development for the member countries that are in need for the much sought after foreign direct investment. In the main, investors feel more secured in investing in countries with clear and unambiguous legal regimes, especially ones that give them the opportunity to check the activities of managers and have a say in the affairs of the companies in which they have invested. In line with this thinking, OHADA Member countries have put

* LL.B (Hons) (Buea, Cameroon), Maîtrise (Yaoundé II), LL.M (UWC, Cape Town), LL.M (Harvard Law School), Doctoral Candidate, Centre for Human Rights, University of Pretoria.

commercial law reform at the forefront of their development agenda. The sad thing though is the unjustified absence of a comprehensive guideline on corporate governance. In my opinion, the absence of a Uniform Act on Corporate Governance or at the very least, a guideline on corporate governance is a shortcoming in the wonderful harmonization efforts. In a world that corporate governance rules and principles have been heralded as a necessary tool for development, OHADA countries should not be left out. There are pockets of corporate governance principles in the OHADA Laws, especially the Uniform Act on Commercial Law. However, I think they are at best insufficient and at worst not visible. In this article, I advocate for an OHADA Corporate Governance Guideline. I acknowledge the difficulties of having a set of detailed provisions on corporate governance in the form of traditional uniform acts. As such, I propose a different and simple mechanism through which OHADA Member Countries can legislate on corporate governance rules. I evaluate the pros and the cons of both a principles-based and a rules-based regime and conclude that given the dynamic nature and evolution of corporate governance, a principles-based system would be a better option for OHADA member countries.

The article is structured as follows: Part B explores the universe of corporate governance, specifically looking at what it is. I discuss the Enron Scandal whose consequences ushered in a wave of corporate governance reforms. In Part C, I look at some of the salient corporate governance provisions in the Uniform Act, analyzing their advantages and shortcomings. In Part D, I make a case for an OHADA guideline on corporate governance and how it can be achieved.

B. Meaning of Corporate Governance

Corporate governance refers to the relationship between managers (directors or majority shareholders entrusted with managerial and controlling functions) who control a firm and shareholders (minority shareholders or shareholders having non-managerial functions) who are owners of the firm. It seeks to solve this problem by having a range of mechanisms that aim at aligning the interests of managers who take care of the day-to-day dealing of the firm and shareholders who might be dispersed and might not be vey conversant with the firm's state of affairs. Now-a-days, especially in social democracies like Germany and some Scandinavian countries, employees and to some extent local communities are included in corporate governance discourse and have thus become part of its structure.

Anything that distorts the relationship between managers and shareholders becomes a corporate governance problem. The corporate governance problem might be vertical or horizontal. A vertical problem is mainly between managers and shareholders. Usually, stockholders vote board of directors and board of directors elect managers. This sometimes creates problems, as the board of directors makes most of the decisions. Since shareholders are usually distant and not very conversant with the day-to-day running of the firm, their inputs might not be very valuable. In addition, since they are so distant, there is less likelihood for

their intervention. In such a situation, managers will have no incentive to pay attention to small shareholders, as this group does not have enough authority i.e. much stock in a large firm.

A horizontal corporate governance problem is a problem between shareholders inter se and usually arises where there is a dominant shareholder. In such a situation, small shareholders are worried over the role of a dominant shareholder who is in control. For instance, how will the small shareholders be able to police the activities of the dominant shareholders? Here the small stockholders are concerned more with dominant shareholders than with managers. Some of the problems that small shareholders will be very concerned about include: insider dealing; dominant shareholders bringing their relatives to control the firm; a dominant stockholder transferring value to himself; a dominant stockholder running the company badly as he/she is no longer interested in the value coming in.

Generally, at a particular point in a private company's life, the owner and main shareholder would want to employ skilled and professional managers to assist him to run the firm. This becomes more evident when the company goes public. However, the shareholder who has been accustomed to managing the firm's activities might be hesitant in losing the benefits of control. In addition, and most importantly, he will be weary of the managers – ensuring that he puts mechanisms in place so that they do not steal from the firm. He might have to employ these managers because the company might be too large and he might not have the necessary skills to manage such company. Secondly, minority shareholders would not want a shareholder to maintain control of the company for fear of losing value to the shareholder. The shareholder will even want to employ managers for reputational purposes and for minority shareholders to invest in the company.

In situations where there are separation of ownership and control, there might be an increase in agency costs. Agency cost is the cost that arises as a result of separating ownership from control. Jensen and Meckling[1] note that a firm is not a single thing being acted on by the business world; there is a constellation of persons interacting within the firm. So, a firm should be looked upon as a group of people that do not have the same interest. They underscored three sources of agency costs that affect the firm. These costs are: monitoring cost, bonding cost and residual loss.

Monitoring costs are costs that shareholders bear in keeping an eye on what managers are doing. Bonding cost typical arises in situation where managers will want to signal to their shareholders that they are doing well. As a result they will spend time doing non-productive things in order to make the shareholders know that they are doing their work well. For instance, they might enter into some con-

1 M. Jensen & W. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure', *Journal of Financial Economics*, Vol. 3, No. 4, 1976, available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043>.

tracts, which may be good in the eyes of shareholders, but not good for the company. Residual loss is loss associated with satisfying securities regulations. Corporate governance is to make this cost tolerable for the large firm to survive.

I. Enron Scandal and the Sarbanes Oxley Act

The Enron scandal is the biggest accounting fraud in US history and also constitutes the biggest bankruptcy in American history. In November 2001, Enron, which had been hailed as the prototype of a successful company and whose shares were at a record high of $ 90 in the first and second quarters of 2000 found the said share price plummeting to $ 1. The demise of Enron paved the way for a series of regulation and once more, reignited the need for transparency in general and shareholder access in particular.

Formed in 1985, Enron was a merger of Houston Natural Gas and InterNorth. The resulting merger between the two created America's biggest gas pipeline system. Following the problems with the gas market and the consequent hiring of Jeff Skiling, Enron moved its business into risk management products and long term contracting structures.[2] The company's business strategies became an instant hit and its revenues increased from $ 40 billion in 1999 to $ 100 billion in 2000.[3] However, this was not the true situation as Enron's executives kept its debts off Enron's balance sheet thereby maintaining a higher credit rating for the company.[4] This scheme was apparently approved by Enron's auditors, Arthur Andersen.[5] In mid 2001, Enron was required to correct its financial statements, resulting to more debts to the company, which culminated in its bankruptcy.[6] Many reasons have been advanced as to why such a system existed at Enron. They include: waiver of the code of ethics (conflict of interest) provision with regard to the Chief Executive Officer; stock sales by Enron executives and lack of auditor independence (Arthur Andersen was providing consulting services to Enron, engaging in internal audit work and had some of its staff take up permanent positions at Enron).[7]

The Enron Scandal is just one example of how inadequate corporate governance principles in this case, absence of a proper monitoring mechanism and dismemberment of corporate functions can cripple big business. After Enron, other scandals such as World Com followed. As mentioned earlier, these scandals brought to the fore the need for corporate governance rules that could be responsive to emerging global business trends. Prior to Enron, there had been discussions on ways to improve corporate affairs and make it more transparent and open especially to minority shareholders.

2 *See* B. Stewart, 'The Real Reasons that Enron Failed', *Journal of Applied Corporate Finance* 2006, p. 117.
3 *Id.*
4 *Id.*
5 *Id.*
6 *Id.*
7 *Id.*

However, it is safe to say that the momentum for the quest for corporate governance rules grew in leaps and bounds after the scandal, with the US leading the way with the enactment of the Sarbanes-Oxley Act. Many other countries followed suit by enacting corporate governance laws. OHADA Member countries for instance, enacted the Uniform Act on Commercial Companies that contain a series of corporate governance provisions. These provisions would be examined in the section below.

C. An Analysis of Some Salient Corporate Governance Provisions in the OHADA Uniform Act on Commercial Companies and General Interests Groups

The corporate governance provisions in the Uniform Act relating to Commercial Companies and Economic Interests Groups amongst other things, deal with: the protection of minorities; presence of preemptive rights; appointments of statutory auditors; creating a balance between corporate and social interests; double voting rights for shareholders who have held shares in their name for two years etc. These provisions will in turn be discussed below.

I. Pre-Emptive Rights

The shareholders are entitled to a pre-emptive right in proportion to the shares they hold in a company.[8] They cannot be deprived of this right.[9] In practical terms, this will mean they will always have the right to subscribe to new equities by the company. However, this rule will not apply in instances where a shareholder waives such right or where the extraordinary meeting of shareholders decides that there will be no pre-emptive right with regard to certain share increase.[10]

II. Appointment of Statutory Auditors

There is the provision for the appointment of Statutory Auditors under Chapter Two. Article 702 provides that companies that do not make public offerings must appoint a statutory auditor and a deputy. For companies that make public offerings, they must appoint two auditors and two deputy auditors.[11] The statutory auditor and its deputy are appointed by either the company's statutes or the constitutive assembly.[12] They are initially appointed for a two-year period, but could have their terms extended for six years.[13] Some of the notable functions of the statutory auditors include: certifying the company's accounts;[14] verifying the

8 Art. 573 OHADA Uniform Act.
9 *Id.*
10 *See* B. Martor *et al.*, *Business Law in Africa: OHADA and the Harmonization Process*, (2nd edn), London 2007, p. 101.
11 Art. 702 OHADA Uniform Act.
12 Art. 703 OHADA Uniform Act.
13 Art. 704 OHADA Uniform Act.
14 Art. 710 OHADA Uniform Act.

accuracy of a company's financial situation;[15] provide a report to the ordinary general meeting wherein the auditor confirms the accuracy of the company's accounts or refuses such confirmation and give its reasons for the refusal.[16]

III. Protection of Minority Shareholders

Protection of minority shareholders has been achieved in a couple of ways. First, through pre-emptive rights as discussed above, through double voting rights if such shareholders have held shares in their name for two years and through the possibility of a shareholder via a court appointed officer to call a general meeting of shareholders which might be ordinary general meeting or an extraordinary general meeting, depending on the issue to be discussed. The flip side of this though, is that such shareholder must have at least one tenth of the capital held by the shareholders entitled to attend such a meeting.[17]

IV. Double Voting Rights

Article 544 allows for shares to be created with double voting rights for certain shareholders who have held shares in their name for two years. This could be useful to protect certain shareholders who must have acquired shares during incorporation against hostile take-overs or freeze out mergers. In addition, it gives them certain leverage in the decision making process be it during the ordinary general meetings or the extraordinary general meetings.

D. Why an OHADA Guideline on Corporate Governance

The above notwithstanding, I strongly believe OHADA member countries need to have an OHADA Guideline on Corporate Governance. My belief stems from my many years of witnessing companies in my country going bankrupt in unenviable style and fashion or bogged down in mismanagement quagmire partly as a result of the absence of robust corporate governance rules. This belief has been strengthened by my current scholarship and views gathered from discussions with corporate law professors, policy makers, corporate lawyers and legal officers of international financial institutions. In this section, I will make a case for an OHADA Corporate Governance Guideline. I will propose what reforms and amendments should be made and how they should be made. In the process, I will make references to developments in certain countries that have seen the deficiency and gone ahead in enacting a Corporate Governance Guideline. I am of the opinion that in its quest of being Africa's premier business law regime of choice, OHADA should enact comparatively better pieces of legislation with regard to countries[18] they intend to attract in joining the OHADA Legal Regime.

15 Art. 712 OHADA Uniform Act.
16 Art. 711 OHADA Uniform Act.
17 Art. 516 OHADA Uniform Act.
18 Such as Ghana and South Africa that have good corporate governance laws.

I. Too Much Power of the CEO (in this Case, the President Director General)

Under OHADA Company Law, the head of a company takes three forms. There is the director general in situations where the company has a board of directors, whose president is not the general manager of the company; an administrator general where the company does not have a board of director and a president director general where the said president director general doubles as the chairman of the board of director. Some of these provisions are in line with conventional Western notion of corporate governance. However, there are certain arreas of divergence between the two legal systems. For instance, under OHADA, there is the absence of independent directors, no clear separation between the roles of chairman of board of directors (BOD) and chief executive officer (CEO), and the CEO combining the roles of both the CEO and Chairman of BOD in a portfolio called administrator general. Claire Dickenson argues in a groundbreaking article that the reasons for such a corporate governance structure under OHADA might have been influenced by the desire to make the law simple and flexible.[19] Though these are plausible arguments, I think such a system makes managers more powerful and might not be sustainable, especially in an era where shareholders are becoming more active in corporate affairs. An argument could be made that shareholder activism is not common in most African countries and that shareholders are few and concentrated in African countries as opposed to those in Western Countries that are many and are diffused. A counter argument may be that most of the corporate governance laws of most countries as well as the corporate governance expectations from multinational companies are similar to the extent that there is some degree of a quasi-systemic standardization of corporate governance principles. If one were to go with this strand of reasoning, then there is a case for, at the most an OHADA Corporate Governance Guideline or at the very least, amending the current laws to reflect current global trends.

II. Absence of Independent Directors

The absence of independent directors in my opinion is not justifiable. With a regime making the CEO so powerful, the next thing one would not want to expect is the absence of independent board of directors. We are all living witnesses to the Enron Scandal due in part because of the absence of independent directors. I think OHADA is a step behind by not providing for it. Though it might be argued that this would limit cost and might improve efficiency in the decision making process, in my opinion, the transparency and accountability that an independent board might stand for trumps any efficiency or cost reducing reason. Another argument might be that there is absolutely no guarantee that these independent directors would not collude with the CEO and as such act as a rubber stamp to the latter for their own benefit. This might be foreseeable, but with most African countries criminalizing corporate skullduggery, streamlining their local laws to meet international standards by broadening the scope of what constitutes a crime

19 *See* C. Dickerson, 'Harmonizing Business Laws in Africa: OHADA Calls the Tune', *44 Colum. J. Transnat'l L.* 2005, p. 50.

and lastly by participating in international cooperation to combat crimes, such an argument might be an issue of the past.

III. Disclosure Mechanisms Not Sufficient and Adequate

In addition, in another article discussing corporate governance under OHADA Law, Claire Dickerson holds that the registry system as provided for under the Uniform Act on General Commercial Law enhances greater disclosure which is broader than the fiduciary duties requirements present in certain jurisdictions like the US.[20] Though Claire might have been enthused with the wordings of this provision, the reality in most OHADA member countries presents a different picture. Not all the registries are computerized.[21] In addition, some of the registries have human resource constrains and as such, might find it difficult to keep to speed with the ever increasing corporate and other business filings.[22] One way to get round this snag is to require most companies to have a website wherein they are compelled to publish their annual reports and activities as well as any conflict of interest by the CEO.

IV. Competition Among OHADA Member States Leading to an Unnecessary Race to the Bottom

The OHADA Treaty with its numerous Uniform Acts dealing with various aspects of commercial law is certainly amongst the most significant legal developments to have taken place in Africa. African countries which are signatory to the treaty have seen most of their commercial laws totally revamped setting in motion a more secured, favorable and predictable legal principles. One good thing with this initiative is that countries combine their forces together rather than handle the law reform process individually. This becomes the more relevant in a continent where financial and human resources are below international average. The unfortunate problem though is that not all aspects of business laws are harmonized. For instance, there is the absent of a guideline on corporate governance. This has led a number of OHADA Member countries to enact or contemplate to enact laws on corporate governance for example, Senegal. In my opinion, the absence of a full fledge document on corporate governance is not sustainable and might lead to a race between member countries. This would be a sad development as there might be discrepancies between corporate governance standards, which in many respects hinder harmonization and integration initiatives. To avoid this scenario, there is thus a need for an OHADA document on corporate governance.

E. How May Any Proposed Reforms or Amendments Be Effected

From the forgoing discussions, it is important that there be some laws/guidelines on corporate governance. However, achieving this might not be any mean task.

20 *See* C. Dickerson, 'The Cameroonian Experience Under OHADA: Business Organizations in a Developing Economy', 112(2) *Business & Society Review* 2007, p. 191 *et seq*.

21 My experience of legal practice in Cameroon.

22 *Id.*

From the outset, it should be noted that selecting a corporate governance regime for OHADA member states is no easy task. The first question that may come to mind is which form such a regime should take; should it be rules-based in which case there is a Uniform Act, which is binding on all member states or should it be principles-based, in which case member countries have some flexibility in its application? I look at the pros and the cons of a rules based system and a principles-based regime.

I. OHADA Uniform Act on Corporate Governance – Rules Based Approach.

One of the ways OHADA countries have harmonized their business laws have been through uniform acts. Through this process, a set of legal provisions on a particular area are drafted and after a consultative process, countries, which are signatories to OHADA Treaty adopt it as uniform act. To date, all OHADA Uniform Acts have gone through this process. This could be used with regard to corporate governance.

However, the cost implications and better still, a panoply of ratification and other administrative processes should be major stumbling blocks in using a rules-based approach.

II. OHADA Guidelines on Corporate Governance – Principles Based Approach

Rather than going through the long process of a uniform act, OHADA member countries could simply subscribe to a series of corporate governance principles, which takes the form of guidelines. Such principles will only have soft law status and will be used as persuasive authority. This will serve two purposes. First, in the interim, it will fill the present void created by the absence of corporate governance laws until such time that a more substantive body of laws are created and secondly, countries will have the liberty to choose whether or not to subscribe to it. Another advantage of having the guidelines is that it can be updated constantly to meet current trends and circumstances since making such updates would not require a long and onerous process as if it were a law.

1. Aspects of Principles-Based

a. Using Examples from Other Countries

Another efficient way would simply be to modify laws/principles of an OHADA member country that has legislated on the area and apply it to the other member countries. Senegal, for instance has developed guidelines on corporate governance.[23] Such guidelines might be revised to reflect the positions of other OHADA member countries with a view of making it apply to them.

23 The Senegalese Corporate Governance Code was endorsed by the Senegalese President on 14 June 2010.

b. Comply or Explain Principle

OHADA Member countries might adopt a guideline on corporate governance and apply it on the "comply or explain" principle. Through this principle companies would have the option of complying with the suggested principles or explain the reasons for non-compliance. This will avoid immediate systemic changes in a company and secondly, will give them time to organize so as to comply and effectively implement the guideline. In addition, it would act as a watch-dog against unjustified non-compliance as companies would have to explain why they cannot implement as well as give a road map on when they will implement the guidelines.

F. Conclusion

This paper has given an overview of some of the corporate governance provisions inherent in the OHADA Uniform Act on Company Law. It is submitted that though the said Uniform Act goes a step ahead in modernizing company laws of OHADA Member states which for more than five decades were bogged under the quagmire of complex and often complicated and outdated pieces of colonial laws, it falls short of comprehensively addressing core corporate governance issues. This is untenable for a legal regime hailed as a catalyst for business law harmonization in Africa. In this respect, part of the article discusses the need for a guideline on corporate governance and recommends ways in which this might be achieved bearing in mind the inherent challenges that creates law reform. OHADA would be more attractive and more coherent if it fills this corporate governance void.