

The Corporate Governance approach in the light of classical approaches: The shareholder versus the stakeholder. The case of Rwanda

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Abstract

The concept of “Corporate Governance” derives from an analogy between the government of nations or states and the governance of corporations. Corporate Governance has had no precise and commonly accepted definition to date mainly due to the standing point of departure of the one defining it. Each definition has necessarily to be influenced by the locally existing agency problems, which themselves stem from the socio, cultural as well as legal traditions of different jurisdictions. The most dominating and fashionable definition is that, it is the way how corporate institutions are governed and controlled. This paper seeks not to investigate the deep history of, but to expound on the distinctions between the traditional approaches of; Anglo-American (shareholder value) and the Continental European (Stakeholder value) corporate governance approaches on one hand, and on the other, assess which approach would benefit the Rwandan context given its political and corporate legal history, the existing corporate landscape especially on the ownership structures, and the existing economic level.

The paper starts by the discussion about the two models/theories/ approaches referred to as the classical ones and tries to distinguish one from the other. It further looks at Rwanda’s contemporary corporate institutional and regulatory evolution and thereafter examines which model of corporate governance would then fit better in such circumstances. A conclusion and some recommendations are drawn at the end.

Key words: *Corporate governance, Shareholder value, stakeholder value.*

Introduction

When you examine the meaning and the definition of corporate governance in the context of its evolution in various parts of the world, it becomes evident that the choice has either been leaning to the Anglo- American

shareholder value approach or to the continental European approach – The stakeholder value. This rule will find exceptions however, in some systems that are buying to the kind of ‘hybrid’ system that is neither purely Common-law nor Civil law in nature. This is the case of Rwanda. Where would it then subscribe to? The shareholder value approach of corporate governance or the Stakeholder value?

1. Objectives of and methodology applied

This paper tries to introduce the concept of corporate governance in light of the distinctions between the Anglo-American (shareholder value) and the Continental European (stakeholder value) corporate governance (classical) approaches. The paper further assess which approach of the two would benefit in Rwandan context given its political and corporate legal history, the existing corporate landscape especially on the ownership structures, and the existing economic level. The paper dwells much on Rwanda’s contemporary corporate institutional and regulatory evolution and examines which model of corporate governance would then fit in such circumstances. It also examines the regulatory approach in orienting the choice, and then, a conclusion on Rwanda’s approach is drawn.

2. Introduction to the shareholder and stakeholder value approaches

The term or the concept of “corporate governance” derives from an analogy between the government of nations or states and the governance of corporations¹. Corporate Governance has had no precise and commonly accepted definition to date mainly due to the standing point of departure of the one defining it. Each definition has necessarily to be influenced by the locally existing agency problems, which themselves stem from the socio, cultural as well as legal traditions of different jurisdictions. However, the most dominating and fashionable definition as Farrar notes, is that it is the way how corporate institutions are governed and controlled. This definition originates from the Sir Adrian Cadbury report of 1992² which definition has been reviewed by Cadbury himself since³. The first definition of Sir

¹Alexander N. Kostyuk et al, *Corporate Governance*, VirtusInterpress, Sumy (Ukraine), 2007.Chap.1

² Sir Adrian Cadbury Committee, 1992.

³ Sir Adrian Cadbury revised his definition (*ibid*) in 2003 when he broadened it by saying:

“In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally, to require accountability for the stewardship of these resources.”

Cadbury's committee fell to the Anglo-American shareholder value approach as opposed to the Continental European stakeholder value which advocates for a broader coverage of the main corporate objective – the business' sustainability through balancing the stakeholders' interests.

The two approaches mentioned above root from the two diverging understanding of the principal objective of the corporation or firm. In the Shareholder value approach, a corporation's principal objective is to maximize the profits in the interests of the shareholders who are considered to be the sole residual claimants from the corporation. Stakeholder value theory from the continental European countries on the other hand, provides that the objective of the company is not limited to the shareholders alone, but it is to the benefit of all those who can be identified as its stakeholders. The directors are not only to manage the company for the betterment of shareholders, but also in the interests of a multitude of stakeholders (including the shareholders)⁴ who can affect or be affected by the actions of a company⁵.

One would then wonder, what would be the best corporate governance approach in jurisdictions in the less developed world like Rwanda, whose corporate system is dominated by medium and relatively small companies with just a single digit number of these companies being publicly listed, compared to those in these other countries? Which of the two models of corporate governance would fit for such developing economies? Would a mixture of both serve better for such developing economies than adopting either of the two? So, what does Rwandan law and practice provide or signal to provide in as far as the choice of the corporate governance approach is concerned?

3. Corporate Governance – The Rwandan approach

Although company law and corporate governance structures⁶ had existed right since the introduction of the written law in Rwanda by the colonialists

⁴ It is argued here that, directors are requested to balance the interests of stakeholders every time they are to take decisions on behalf of the corporation.

⁵R Edward Freeman, 'A Stakeholder Theory of the Modern Corporation' in Tom L. Beauchamp and Norman E. Bowie (eds), *Ethical Theory and Business* (5th ed, 1997) at 69. It should be noted that the meaning of 'stakeholder' is a matter of some debate. For instance it might be said to encompass groups vital to the success and survival of the company. See, for example, Freeman, 'A Stakeholder Theory of the Modern Corporation' at 31.

⁶See for example, arts 189 – 203 of the 1988 law on companies particularly on the conduct and liability of corporate directors vis-à-vis the company and third

in the late 1800s, the concept of ‘corporate Governance’ is relatively new to this part of the world! It is not surprising though, since it is still regarded a new concept even in the developed part of the world. In Rwanda, corporate governance can be said to have surfaced the way it is understood today right from the emergence of the privatization drive that started in early 1996⁷, just two years after the 1994 tragedy (the Genocide against the Tutsis) that befell the country.

In early 2000, with the emergence of many new businesses in excitement of the stable security situation inside the country after all insurgencies, another issue emerged. Scandals especially in the financial sector were prevalent. Many of financial institutions were declared insolvent before or around 2005 due to poor corporate governance. The most notable ones were The Bank of Commerce, Development and Industry (BCDI) and the *Banque Continentale Africaine* (BACAR). The government of National Unity had to intervene and bail out some banks for the benefit mainly of the depositors whose savings culture with the banks had remarkably developed and which, the government did not wish to relent. After the successful prosecutions of the managers of these banks (Alfred Kalisa and Kajeguhakwa respectively) who were at the same time the majority shareholders of the same banks, but who were highly implicated in abuse of their positions⁸ as directors and managers of the banks to enrich and benefit their own interests at the expense of the companies, minority shareholders as well as the depositors. These companies (banks) were later acquired by foreign companies: ECOBANK and FINA Bank respectively.

By late 2000, and following the struggle to recover from the repercussions of the above mentioned scandals in the financial sector, a number of corporate governance regulations especially in the financial sector still, were established. In these regulations, the major concerns from the community such as the accumulation of power (for example, combining Chairmanship of the board with the functions of the CEO), abuse of office

parties (*Loi n° 06/1988 du 12 Fevrier, 1988 portantsurl’Organisation des sociétés commerciales (J.O., 1988, p. 437)*).

⁷ The Law establishing the Privatisation Programme was published on 11/March/1996. This was a Law on Privatisation and Public Investment. The Presidential Decree of 3/May/1996 put in place institutions to implement the Privatisation Programme, but the Privatisation Secretariat actually started to be operational just one year later (October 1997).

⁸ Read in the article ‘Former BCDI boss arrested’ In *The New Times* (Rwandan daily English newspaper) of 9th January 2007. Also available on: <http://allafrica.com/stories/200701090519.html>

and self-interests dealings were catered for. For example, art.20 of the corporate governance regulation of the Insurance business provides that;
“To guide against potential conflict of interest, no individual shareholder with a qualifying holding shall be appointed as a chairman of the Board.

The responsibilities of the Chairman of the board must be clearly separated from that of the Managing Director or Chief Executive Officer to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making.

No person shall combine the post of Chairman of the board and Chief Executive Officer of any institution”⁹.

In the year 2000, the Rwandan Government had put to public its ambitious long-term development goals as embodied in what it termed as ‘Rwanda’s Vision 2020’. Among its pillars was an emphasis on good governance – both in the public as well as in the private sector. This vision is the guiding path for the country’s development plan. It has since become owned by each and every segment of both public and private sector. By September 2007, Rwanda had published what it referred to as ‘Rwanda’s Economic Development and Poverty Reduction Strategy (EDPRS) in which, the country reemphasizes its commitment to supporting the development of “soft infrastructure” for the Private Sector through implementing the commercial justice, business and land registration programmes, improving economic freedom, improving the regulatory and licensing environment for doing business, and *promoting principles of modern corporate governance*¹⁰. In so doing, a review of most business laws was initiated from 2007 in a bid to ease doing business in Rwanda. This however, did not jeopardize the growing trend towards embracing the good governance practices – and corporate governance in particular. In 2009, the new company law was promulgated replacing the 1988 law on commercial enterprises in Rwanda. In the new law as the trend in government policies shows, corporate governance surfaced for the first time in Rwandan

⁹ Art. 20 of the Regulation no. 07/2009 of 29/07/2009 on corporate governance requirements for insurance business, published in the *Official Gazette* n°35 Of 30/08/2010. Available at: [http://www.bnr.rw/docs/publicnotices/ Insurance%20 regulation%20n07%20copportate%20governance.pdf](http://www.bnr.rw/docs/publicnotices/Insurance%20regulation%20n07%20copportate%20governance.pdf) (Accessed on 19/12/2011). The article goes further in its last paragraph to emphasize the separation by defining what it means in the term ‘relatives’ where it says:

“Two members of the same extended family, referring to spouse or family member up to second degree, are not entitled to occupy the position of Chairman and Chief Executive Officer or Executive Director of an institution at the same time”.

¹⁰ Point 19 of the Executive Summary of the EDPRS document, *op.cit.*

company codes. It was intended to strengthen investor protection by requiring greater corporate disclosure, accountability, increasing the liability of directors and improving shareholders' access to information. The adoption of this law was among the factors that made Rwanda to be ranked the best reformer in the World Bank's *Doing Business* ranking of 2010. To Rwandan government and people, ranking first on the world's list of reformers was a reward to their steady efforts towards an economy rooted in professionalism, accountability and responsibility.

4. The legal and regulatory orientation on the choice of corporate governance approach in Rwanda

As seen from the brief historical evolution of business framework in Rwanda, business and so its institutions are relatively young and small. Most if not all, may be qualified as Small and Medium Enterprises. This however, does not rule out the fact that they too, deserve to embrace best corporate governance practices that may become their solid foundations for their business' future development. Quoting from the BIZCLIR¹¹'s comment on Rwanda:

“Although most businesses in Rwanda are of a size that does not merit advanced corporate governance procedures and protections, many public and private sector representatives believe that, as the economy advances, corporate governance will become a very important issue and, thus, is necessary to address and build on today. Furthermore, even the smallest businesses would benefit greatly from a culture that respects and implements corporate governance on the most basic level. Currently, most companies are owned by individuals and families, not shareholders, and many are informal. Nonetheless,... basic business management are important to their success, regardless of their size. Many small businesses reportedly do not incorporate these practices into their business activities.”

By its own initiative, the Rwanda Private Sector Federation published the Corporate Governance Code for its members. In that code, it is noted that it was aimed at improving and strengthening the corporate governance standards as well as improving efficiency and competitiveness.

¹¹ BIZCLIR is a USAID funded programme that assesses commercial laws and institutions that facilitate trade by assessing the existing legal and institutional framework and the implementation of these laws and policies. For more information on BizCLIR on Rwanda, see: http://www.bizclir.com/cs/countries/africa/rwanda/protecting_investors

This Code was however published as a guide for companies to use as they developed their own codes of corporate governance for use in their respective companies.

The law does not explain what would be the best interest of the company, neither has the courts discerned on what this would be standing to mean. Although this law (2009) is very well articulated in terms of shareholders', especially the minority protection, it is found to be lacking in terms of describing the duties of the company directors and officers. If Art. 211 of the 2009 Rwandan Company Law was to be compared to for example the UK ss. 172¹² and 174 CA 2006, you would realize that there is a lot that would be added to the Rwandan legislation.

Never the less, I contend that, just like it is in the Anglo-American Shareholder approach, Art. 211 provides an unlimited discretionally powers to the directors and officers to do whatever they would wish with the company's resources and within the company, provided it can be justifiable as being 'to the best interest of the company'. Within such discretion, directors may subjectively or objectively commit the company's resources to any activities. It is noted that throughout the legislation, employees are not catered for as for example, one of the constituents of the residual claimants from the company's deeds.

This is the reason too, that the whole legislation is highly dedicated to the investor protection than to any other thing. Art. 212 present it all. It impliedly provides for whom the directors are answerable. Although Art.211 was not explicit on the duties and to whom these duties are performed, Art. 212 provides for the liability in case of breach of the duties by the director (s) or officer (s) of the company.

It is only to the company and indirectly, the shareholders that the directors or officers are liable in case of breach of their duties.

So, this coupled with many other provisions in favor of shareholders and empowering shareholders herein the 2009 company law, it is submitted that by the legislation (2009 company law), Rwandan statutory approach is for the Shareholder Value approach than the Stakeholder one or even the UK's "Enlightened Shareholder Value". The company law for example expressly defines the company as "a corporate body composed of one or more

¹² The UK position under s.172 CA 2006 is explicit on what the duties of directors are and to whom those duties shall be directed. The principle of 'Enlightened shareholder value' imposing duties to a wider group of shareholders not just the shareholders is clearly expressed in the law.

persons *for making profit*¹³. The last part of this definition states clearly the main objective of the company. It can therefore be deduced that it shall be to the company's interests, every time a decision is taken to increase profits regardless of what the process of achieving such profits might be. Such was the same argument advanced far back in 1970 by Friedman where he wrote that "the social responsibility of business is to increase its profits"¹⁴.

Juxtaposed to the above however, the Guiding Corporate Governance Code as published by the Private Sector Federation of Rwanda hints on the company directors considering other stakeholders too during their (Directors') decision making process. In a relevant part on the role and duties of a director, the code points that: "*Identify the corporation's internal and external stakeholders and agree on a policy or policies determining how the company should relate to them*"¹⁵

In this case, unlike its reiteration to the maximizing shareholder and company value in most parts, the code brings in the consideration of the interests of other constituents both inside and outside the company. This is also the case where the code in its chapter XVII and chapter XVIII provides for responsibilities to other stakeholders including the employees and on the Corporate Social Responsibility especially on the impact the company's activities would have on the environment in general and the community where the company operates from, in particular.

In its Annex 1 relating to the "Board of Directors' Charter", the guiding code reiterates on the directors' duties as to always dispense their duties in the 'best interest of the company, and on the honesty and diligence' all of which were mentioned in the Companies Law. However, they also mention other stakeholders as being among the core to attract the director's attention while dispensing their duties with the company. In a relevant part it is mentioned that: "*Consequently, directors undertake to take into account not only the possible financial impact of their decisions but also their consequences for sustainable development, their effect on relations with stakeholders and the general interest of the communities in which the company operates*"¹⁶.

¹³Art. 2(12), Law N°07/2009 of 27/04/2009 Relating to Companies, OG N°17bis of 27/04/2009.

¹⁴ Milton Friedman, 'The Social Responsibility of Business is to increase its Profits', *The New York Times Magazine* [New York], 13 September 1970.

¹⁵ Guiding Code of Corporate Governance, Private Sector Federation – Rwanda, English & Kinyarwanda July, 2009, pg.6.

¹⁶Board of Directors' Charter, Ibid, art. 2.

Being a practice that is taking root even in private sector, there is undoubtedly hope that it will develop much faster than where it would be primarily forced and spearheaded by the regulatory institutions or from the Civil Society Organizations. What is remaining to assess is how much this guiding code has impacted in companies adapting to it or establishing their own ones.

5. Conclusion

Despite globalization, corporate governance patterns continue to differ, and that is because business but also social practices are not uniform. Differences are created by: - The extent to which laws are enforced, the treatment of stakeholders such as the employees and the surrounding community, the ways in which executives are compensated, the frequency and treatment of mergers and takeovers, patterns of ownership, business customs in the country concerned, significance of the stock market in the country, concentration of ownership and many others. This is still the rule, rather than the exception¹⁷.

In my analysis of the Rwandan Company law of 2009 as amended to date, I contend that the law is not explicit on which model of corporate governance it does ascribe to. I noted however that, analyzing it (the law) as a whole, it can impliedly be deduced that it ascribes to the shareholder value approach, given the radical importance of the shareholder that is emphasized throughout the legislation. This is not surprising though, since, as discussed in the evolution of the Rwandan business climate, it was seen that the dominant agency problem that existed before the promulgation of the 2009 company law was shareholder/director and sometimes doubling as the majority shareholder relationship that prevailed. No wonder therefore that the law clearly addresses the investor protection especially the minority ones, and addresses at the same time the shareholder/directors relationship.

It has been observed however, that there is insufficient information whether from legislative part or from courts on what statements like ‘to the best interests of the company’ would mean in order to ascertain whether it included the stakeholder interests as well or not.

Nevertheless, I have also shown that private sector or even individual companies have voluntarily embraced corporate governance practices by

¹⁷ International Chamber of Commerce: *Corporate Governance: A basic guide for business practitioners*. Available at: <http://www.iccwbo.org/corporate-governance/id3173/index.html> [accessed on 13/01/2012]

publishing what they consider as their corporate values and good practices. The Rwanda Private Sector Federation (PSF) has gone to as far as publishing the Guiding Corporate Governance Code for member companies to use while designing their individual corporate governance codes since there exists no compulsory standards whether for the private or public companies. What is interesting to note from the private sector initiative is that their approach shows a mixture of both the features of the Shareholder Value approach by putting the shareholder and the ‘company’ at the forefront, but at the same time, considers the interests of other constituents like the company employees, a character that is advocated for by the Stakeholder Value proponents.

6. Recommendations

The first recommendation is that there is an urgent need for the establishment of a corporate governance policy framework that would guide both the public and private sector players for a sustainable business development in form of companies.

There should also be a clear harmonization of laws relating to corporate governance in order for them to reflect the corporate governance policy framework once in place.

The government, through the policy framework should be clear on what the ‘best interest of the company’ issue is since, without this, corporations will go forward to exploiting all the opportunities in order to maximize profits while in total regard of a broader company interests of protecting the environment, its employees, good relations with the regulators (being compliant) etc.

There should be a comprehensive, but non-compulsory corporate governance code which caters for all different business sectors rather than having one for each sector like that of the financial sector.

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