

**KEYNOTE ADDRESS**

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**CORPORATE GOVERNANCE: FACILITATING THE WAY FORWARD**

**WEDNESDAY FEBRUARY 15, 2006**

**ADDRESS BY VINDEL KERR:**

**“THE ROLE OF CORPORATE GOVERNANCE IN ENSURING THE THREE Es-  
ECONOMY, EFFICIENCY AND EFFECTIVENESS”**

**Chairman, Hon. Fitz Jackson, Minister of State in the Ministry of Finance  
and Planning; my colleagues on Platform Ann-marie Rhoden, Archibal  
Campbell and Mr. Leighton McKnight, my esteemed colleagues in the  
audience, Ladies and Gentlemen, Good Morning!**

**Corporate governance** refers to how a corporation is directed, and the laws and customs affecting that direction. It includes the laws governing the formation of firms and the bylaws establishing the firm itself. It also includes the structure of the firm. The corporate governance structure specifies the relations, and the distribution of rights and responsibilities, among primarily three groups of participants: the board of directors, managers, and shareholders. This system spells out the rules and procedures for making decisions on corporate affairs.

It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring the performance of those objectives. The fundamental concern of corporate governance is to ensure the conditions whereby a firm's directors and managers act in the interests of the firm and its shareholders, and to ensure the means by which managers are held accountable to capital providers for the use of assets. Within the framework of corporate governance are issues of fiduciary duty and accountability.

The question of how corporations should be governed, in order to achieve economic performance, has been widely discussed in the United States, the United Kingdom, and other Countries, over the past two decades. Until recently, the subject of corporate governance has attracted little attention on the European Continent, in Asia, and in other parts of the world. By the late 1990s, however, corporate governance had become a major, highly contentious issue in all advanced economies; and, increasingly, in middle-income and/or developing economies, as well. International organizations, such as the World Bank, and the IMF, have been devoting increasing attention to corporate governance as a topic of global importance. They (World Bank –through IFC), and OECD, have been promoting CG mainly in the transitional economies of Eastern Europe, in Africa and, only recently, in the Caribbean.

The relevance of corporate governance in developing countries like those in Caribbean is further enhanced by a rush towards market-driven policy changes. These policy changes represent the influences of globalization on market forces, relative to that of regulation by institutions. Also, corporate governance is influenced by the insensitivity and ignorance of many persons at the very helm of governments. The private sector is not to be spared as an obstacle to corporate governance reform, as they, or elements thereof, have for a long time, been

involved in concentrated oligopolistic-like local power structures that either, are conducive to, or promote self-dealing by corporate insiders. Such behavior tends to result in huge waste of corporate-controlled resources, an inefficient economy, reckless use of capital, as well as, to perpetuate or exacerbate local inequalities, and thus create hindrances to long-term development.

The effectiveness of boards of directors (BoD), or lack thereof, has become a global issue. Corporate collapses, fraud cases, shareholder suits, or questionable strategic decisions are drawing attention to the top decision-making body of corporations: the board of directors. In an attempt to raise the standard of the corporate governance process, several countries, global institutions, and institutional investor organizations have drawn up what is called “Codes of Best Practices”, and publicity is being given to the need for more effective governance systems in many countries.

An example of a weak (or perceived) governance system that had attracted public attention was a case in Jamaica. The ‘Sunday Observer’ (October 17 1999), in a front-page article entitled, ‘Busting The Piggy Bank,’ reported fat packets and disparities in public sector salaries. This report followed an informed revelation six months after being brought to public attention that many public sector bosses were in breach of established pay guidelines, and were paying themselves millions of dollars at the expense of taxpayers.

Unfortunately, what would have resulted in widespread resignations and probably imprisonment in other jurisdictions seemed to receive only a casual glance. In fact the Jamaican public received no plausible explanation. However, what remains evident is that the failures were due largely to poor administration, outright neglect and lack of loyalty and diligence by corporate fiduciaries.

There are at least three National Codes that have been resonated with the respective Governments. These are the Singapore National Corporate Governance Code; the Cadbury Report of the United Kingdom and the King Report of South Africa.

As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing

requirements may have a coercive effect. For example, companies quoted on the London and Toronto Stock Exchanges formally need not follow the recommendations of their respective national codes. However, they must disclose whether they follow the recommendations in those documents and, where not, they should provide explanations concerning divergent practices. Such disclosure requirements exert a significant pressure on listed companies for compliance.

Today, I ask where is Jamaica's National Code?

### **WHY IS CORPORATE GOVERNANCE IMPORTANT?**

The frequency of public sector corruption and private sector collapses illustrate that the lack of corporate governance enables insiders, whether they be company managers, company directors or public officials, to ransack companies and/or public coffers at the expense of shareholders, creditors, and other stakeholders (employees, suppliers, the general public, etc.). Yet, in today's globalised economy, companies and countries with weak corporate governance systems are likely to suffer serious consequences above and beyond financial scandals and crises. What is increasingly clear is how corporate are governed commonly referred to as corporate governance—largely determines the fate of individual companies and entire economies in the age of globalization.

Globalization and financial market liberalization have opened up new, international markets with the possibility of reaping stunning profits. Yet it has also exposed companies to fierce competition and to considerable capital fluctuations. National business communities and company managers are learning that in order to expand and be internationally competitive they need levels of capital at more competitive price.

Failure to attract adequate levels of capital is bound to affect the very existence of individual firms and can have dire consequences for entire economies. Lack of sufficient capital for example, erodes firms' competitiveness, eliminating jobs and hard-won social and economic gains thereby exacerbating poverty. Firms unable to attract capital, run the risk of becoming suppliers and vendors to the global multinationals or worse yet, being unable to compete and thus be left out

of the international markets entirely, while entire economies run the risk of not being able to take advantage of globalization,

Generally speaking, recent financial crises provoked by corruption and mismanagement have made attracting sufficient levels of capital particularly challenging. These crises cost investors billions of dollars and sabotaged companies financing viability. They also contributed to increased shareholders activism and competition for investment, investors, especially institutional investors, are now making it clear that they are not willing to foot the bill for corruption and mismanagement. Before committing any funds, investors, increasingly require evidence that companies are run according to sound business practices that minimize the possibilities for corruption and mismanagement. Moreover, investors and institutions in Kingston or Kensington, Beijing or Berlin, want to be able to analyze and compare potential investments by the same standards of transparency, clarity and accuracy in financial statements before investing.

The bottom line is that investors seek out companies that have sound corporate governance structures. Just as good government requires transparency so that the people can effectively judge whether their interests are being served, corporations must also act in a democratic and transparent manner so that their owners and stakeholders can make educated decisions about their investments. This is what corporate governance is all about.

What is often overlooked is that corporate governance is just as important for public sector firms as for private sector companies. Instituting corporate governance within public sector firms has recently begun to receive increased attention. This is particularly the case when countries are attempting to curb widespread corruption within the public sector, or when they are preparing public enterprises for significant reform. In either scenario, sound corporate governance measures help to ensure that the public gets a fair return on their national assets.

***How then can Corporate Governance help Public Institutions and a National Economy such as Jamaica?***

Corporate governance helps companies and economies attract investment and strengthens the foundation for long-term economic performance and competitiveness in several ways.

**First**, by demanding transparency in corporate transactions, in accounting and auditing procedures, in purchasing and in all of the myriad of individual business transactions, corporate governance attacks and the supply side of the corruption relationship. Corruption drains companies' resources, erodes competitiveness and tarnishes corporate reputation, and thus drives investors away.

**Second**, corporate governance procedures improve the management of the firm by helping firm managers and boards to develop a sound company strategy, and by ensuring that mergers and privatization are undertaken for sound business reasons, and that compensation systems reflect performance.

**Third**, by developing standards for transparency in dealing with investors and creditors, a strong system of corporate governance helps to prevent systemic banking crises even in countries where most firms are not actively traded on stock markets. Taking the next step and adopting bankruptcy procedures also helps to ensure that there are methods for dealing with business failures that are fair to all stakeholders, including workers as well as owners and creditors. Without adequate bankruptcy procedures, especially enforcement systems, there is little to prevent insiders from stripping the remaining value of an insolvent firm to their own benefit. This happened on a wide scale during many of the privatization efforts in transitional and emerging markets with disastrous results.

**Fourth**, recent research conducted by McKinsey & Co has shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets. Comparisons of countries that base their laws on different legal traditions show that those with weak systems

tend to result in most companies being controlled by dominant investors rather than a widely dispersed ownership structure.

This is particularly relevant to Jamaica where more than 75% of the controlling interests in our publicly traded companies are either very closely held by few individuals or institutions. The owner institutions themselves are the said group of companies.

What's more, instituting corporate governance practices greatly enhances the public's faith in the integrity of the reform process, particularly privatization, and helps ensure that the country realizes the best return on its investments. This will, in turn, stimulate employment and economic growth.

Improved board practices and structures, can increase the effectiveness and credibility of the board. Such improvements are particularly important when there is a widespread belief that directors are affiliated with politicians and controlling shareholders, management or other interested parties. Every public agency should have a very clear policy setting out how its board will consider and decide matters which involve potential conflicts of interest. Such policies should be drafted taking into account the particular circumstances of the Entity's business, its ownership and management, and the composition of its board.

Board policies should require directors affiliated with an interested party in a transaction under consideration to remove themselves from board discussions and voting. Where the nature of the company's business is such that such transactions are commonplace, the best solution may be to establish a standing "conflicts committee" of the board with clear terms of reference and composed of directors that are not affiliated with the involved parties.

In order to ensure clear lines of responsibility and accountability to the full board, the Minister, Public Accountants Committee and ultimately to the nation,

only members of the board should be members of board committees. Members of board committees with responsibility for oversight of critical management functions and conflicts of interest should meet among themselves on a regularly-scheduled basis. Independent members of the audit committee should meet periodically with the company's external auditors without the presence of management. However in the ordinary practice of meetings, key management figures, such as the Chief Executive Officer, Chief Financial Officer and those in charge of internal controls, can be expected to attend meetings of the audit committee.

The significance of corporate governance is now widely recognized, both for national development and as part of international financial architecture as a lever to address the converging interests of competitiveness, corporate citizenship and social and environmental responsibility. It is also an effective mechanism for encouraging efficiency and combating corruption. Companies are governed within the framework of the laws and regulations of the country in which they operate. Communities and countries differ in their culture, regulation, law and generally the way business is done.

In consequence, as the World Bank has pointed out, there can be no single generally applicable corporate governance model. Yet there are international standards that no country can escape in the era of the global investor. Thus, international guidelines have been developed by the Organization for Economic Co-operation and Development (OECD), the International Corporate Governance Network and the Commonwealth Association for Corporate Governance. The four primary pillars of fairness, accountability, responsibility and transparency are fundamental to all these international guidelines of corporate governance.

**Finally**, strengthening disclosure, transparency and accountability in public sector, can greatly increase the likelihood of success of the wide and varied efforts being undertaken in the region to contain official corruption and restore

public faith in government. Many, if not most, cases of public corruption involve collusion between public officials and private sector participants acting in their capacity as executives, employees or controllers of private firms. Adequate checks and balances within the corporation, proper oversight of executive management by the board of directors, better internal controls and clear lines of accountability reduce the opportunities for managers and others associated with the company to involve the firm in incidents of public corruption.

### ***Boosting the performances of government***

If government could improve its performance easily, it would have done so already. Competition is the most important missing element. More than a decade of McKinsey Global Institute research around the World shows that monopolies, businesses protected by government regulation, and other private-sector companies without competitors nearly always have very low productivity. Without competition, managers have little incentive to take risks on new technologies.

When creating competition in the public sector proves difficult, its leaders must find ways to devise other incentives. In the United Kingdom, the Gershon Review of public sector's efficiency has given each government department three-year productivity targets covering financial savings and head count reductions while at the same time ensuring that services will continue to be improved. Making performance of government more transparent by publishing the results of customer satisfaction surveys, benchmarking surveys, and service-quality metrics also helps citizens to take an active role in demanding change.

The call for a new focus on government productivity isn't meant to serve as a justification for thoughtless cuts in government spending or for union bashing inspired more by ideology than by a quest for effectiveness, nor is it meant to induce complacency in the face of the hard budget choices that Jamaica faces.

Instead, citizens' call to action should be seen as a necessary dialogue on the role that government productivity can play in making the perennial fiscal challenges more manageable and humane. In an era of a fiscal tightening, everyone should welcome a more efficient government to ensure that more money is available for social needs.

Over the past decade, several public sector organizations around the world—schools, public-welfare agencies, health care systems, postal and transit systems, and militaries—have improved their performance by 5 to 30 percent or more. Often they have chosen among three classic management tools to raise productivity:

1. Organizational Redesign and Human Capital Rightsizing;
2. Strategic Procurement and Outsourcing and
3. Business Process Re-Engineering.

In the most effective cases, these tools have resulted from the overarching corporate leadership philosophy and practice of **Effective Corporate Governance** and have been part of a broader program of cultural change that transformed the organizations' performance and measured it rigorously.

### 1. **Organizational Redesign and Human Capital Rightsizing**

A redesign that focuses on the end “user” eliminates duplication, and streamlines processes can improve both the cost and the quality of services. Consider the experience of the **US State of Illinois**. In 1997 it put public-aid programs from six separate departments under a single roof. Previously it had been necessary to approach each separately and to give them the same information even though more than half of their 1.8 million customers received multiple services. The new Department of Human Services is a one-stop shop ensuring that recipients get all of the services they need—in the past many of them hadn't—and eliminating the duplication of programs and back office processes. As a result,

the department has redeployed money and staff to new programs, such as an early intervention initiative.

**The German Federal Employment Agency (Bundesagentur für Arbeit)** has also reorganized amid a controversial and often bitter public debate about the future course of German social and labor policy. Headquarters have been shrunk down to 400 staff members, from 1,100, and operational responsibilities have in effect been decentralized to ten regional divisions. The radical redesign of local agencies and their service offerings has been successfully prototyped and now gives customers tangible benefits, such as halving waiting times and doubling the amount of time available for counseling. These changes have led to much higher customer satisfaction levels.

## **2. Strategic Procurement and Outsourcing**

Improving supplier-management and purchasing operations can help public organizations cut their expenditure while raising the quality of the goods and services they buy. Governments mounting such efforts usually standardize and consolidate orders, designate preferred suppliers, reward them for meeting delivery and quality targets, and collaborate with them on ways to improve production processes and reduce costs. Government regulations sometimes make revamping public-sector procurement difficult, but enormous progress can still be made: The State of Illinois (USA) saved more than \$100 million in fiscal year 2004 and expects to save more than \$200 million in fiscal year 2005 (**see Sidebar “How Illinois cut its purchasing bills”**). For many items, the state is getting better quality to save more than \$300 million annually in Medicare and Medical costs, without any changes in health outcomes, by purchasing the cheapest drugs available rather than name brand ones.

Schools throughout the United States have saved 10 to 35 percent on food, janitorial services, textbooks, and transportation by purchasing them more astutely. The United Kingdom is trying to capture this opportunity through its

**Smart Acquisition program**, a set of reforms designed to reduce bureaucracy, cut procurement costs, and speed up the delivery of equipment.

The Jamaica public sector could benefit by peering at the areas of highest spending where there is room to maneuver.

### 3. **Business Process Re-Engineering**

Re-engineering operational processes to reduce waste, eliminate unneeded efforts, and correct mistakes quickly can also raise productivity to an astonishing extent. Consider the experience of the **United States Postal Service (USPS)**. Since 1999 the number of addresses it serves has increased by seven million—nearly equivalent to the number of addresses in the entire Chicago metropolitan area. Nonetheless, the USPS has saved \$5.5 billion by replicating the best practices of the best sorting plants and by improving its delivery and counter operations. In this way, it cut its full-time workforce to 69,000, mainly through retirement and normal attrition, and increased its productivity by 6 percent.

The recent initiatives in E-government here in Jamaica ought to be applauded.

A government-wide E-government initiative can radically improve service and customer satisfaction while reducing costs. In Singapore an export license that formerly required 21 forms and took three weeks to process now involves one online application that can be approved in 15 seconds.

The **US Internal Revenue Service** can process an online tax return for just \$0.40, compared with \$1.60 for a paper return, and the Arizona Department of Transportation can renew a driver's license online for \$1.60 compared with \$6.50 at a branch office. Combining online delivery with a redesign of the back office

processes supporting it can realize cost savings of 35 to 40 percent – while customer satisfaction soars.

If the execution challenges are daunting, the principles and prerequisites for success are clear. When public-sector operations become more transparent, accountability increases. Benchmarking and tracking performance help managers to raise their game. Exposing activities to competition improves service and cuts costs. The keys are committed leadership, a critical mass of talent, processes that budget for productivity targets, and citizens who know that they have a stake in a better outcome and hold officials accountable for achieving it. One way of building public confidence and media support and of stoking the appetite for change is to design the reform effort so that it delivers high-profile early victories.

In spite of recent reforms in the Jamaican Public Sector, it is without question that we have a long way to go. Yes, a long way to go but this does not mean the process would require a longtime.

I have identified the following areas related to corporate governance that are in need of improvement. If remedied, I am sure the economy could benefit, public entities could significantly improve effectiveness and efficiency, and ultimately greater trust and confidence may lead to economically beneficial spin-off to the wider Jamaican economy:

#### 1.0) The State of the Internal Audit Functions of Public Entities

- a. Are all Public Entities mandated to have an internal auditor?
- b. If so, to whom should that person report?
- c. Apart from the Auditor-General, by whom should these entities be audited?

d. Are there established guidelines for the auditing of these Entities and are these guidelines being followed?

2.0) The Selection and appointment of Directors of Public Agencies;

3.0) The Evaluation of Performance;

4.0) Improved Compensation for Chairmen and Directors of Public Entities;

5.0) The Need for a Public Entity Corporate Governance Code of Practice (PECGCP) and to be administered by a Public Bodies Corporate Governance Council (PBCGC);

6.0) The passage of a “Whistle Blowers” Act to encourage greater disclosure and exposure;

7.0) Reduce the Power of the “Responsible Minister” where the monitoring and leadership of Public Entities are concerned;

8.0) Amend the Public Bodies Management and Accountability Act 2001 (and 2003) to make, **inter alia**, Training, Orientation and Induction of Newly appointed Director of public entities mandatory under Jamaican laws;

9.0) Appoint a member of the official Opposition Party of Jamaica to the Board of every Public Entity, providing that the nominee meets all the due diligence and fit and proper test as stipulated under the respective Entity’s Stature, Company Law of Jamaica and the requirements under the newly propose Public Bodies Governance Council;

10.0) Ensure that Parliament approves the appointment of all Chairmen of the Boards of Public Entity after they are nominated by the proposed Public Bodies Corporate Governance Council;

11.0) Significantly improve the State of Corporate Planning at Ministry and Agency levels. The process of Corporate Planning is highly inconsistent throughout the Jamaican public sector;

12.0) Ensure that Trainer of these Entities have a least an internationally recognized diploma in Company Directing or better, at least a degree in the areas of law, corporate governance, business ethics and other relevant areas;

13.0) Enact a fix term “clause” for the appointment of all State-owned Boards, similar to the Contracts Commission.

I would like to challenge the Ministry of Finance and Planning in two areas before I take your questions. The MF & P must authenticate its authority as the chief police of the public sector fiscal and managerial efficiency. To execute this monitoring role more effectively, there must be a mechanism to do so. Further, you have to lead by example. In addressing the latter first, **to lead by example**, you could reform yourself by taking the prudent decision to cut excess human capital, become leaner and more effective and ultimately send a clear mandate to the rest of the public sector that it can not be business as usual.

The Government’s wage bill is unsustainable and, in fact, could have resulted from being ill-advised. The ambition of Government to bring public sector wages 80% inline with the private sector does not exist anywhere else in the world. It will continue to be a headache to successive Governments. This policy initiative must be aborted in the interest of the national economy of Jamaica. As technocrats, tighten your belts and tell your bosses: **the politicians** that they have to do the unpalatable thing of placing national interest over political expediency. Good and

effective corporate governance has no political expedient agenda—its serves one and only one intent—its embraces whatever is the best practice for the majority of the people in an institution, community or nation.

To monitor government performance more effectively and ensure that the Ministry of Finance & Planning gets its money's worth, I am suggesting that **Sectoral Technical Experts (STE)** be recruited and positioned at the MF & P. The role of each STE would be to monitor performance efficiency and effectiveness (productivity) of each ministry and report on a regular basis to both MF& P and Parliament on the how each Ministry utilizes the resources allocated to them. As part of this process, Permanent Secretaries and the Heads of all Public Agencies should be subjected to a formal performance evaluation annually and their job security be based on this evaluation.

I thank you again for you kind invitation to address you here today.

It would be my pleasure to clarify, explain and shed more light on the points I raised throughout my presentation and in particular, the 13 points highlighted in my departing comments.

I now welcome your questions.