“Assessing the corporate governance practices of the hospitality industry in Ghana”

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Assessing the corporate governance practices of the hospitality industry in Ghana

Abstract

The purpose of this study is to examine the governance practices of the hospitality industry in Ghana. The study compares the governance practices of two sets of hotels (3-star and 4-star hotels) within the context of best practices around the world. The study adopts a comparative case study methodology by comparing the governance structures of 3-star and 4-star hotels. This is meant to ascertain whether these classes of hotels exhibit different or similar governance practices. The findings revealed that governance practices did not meet best practices around the world. Even though, the corporate governance practices are in line with the provisions of the Companies Code, lapses are widespread reflected in board composition and board sub-committee (audit committee) to slate of other procedures that depart from international best practices. It was ascertained that there were similarities and differences in the governance practices of the two classes of hotels. This raises serious concerns which must be addressed if the hospitality industry is to offer the needed boost to the economy of Ghana. The originality of the paper lies in the fact that it considers a unique sector often neglected by researchers in Ghana and also within Sub-Saharan Africa.

Keywords: governance, hospitality industry, Ghana.

JEL Classification: G34.

Introduction

Ghana is gradually shifting its attention from primary commodities to market-oriented economy with emphasis on tourism and the hospitality industry in general. It is widely recognized that the hospitality industry is directly linked to the country’s cultural, economic and intellectual potential. These must therefore be managed to meet international standards in order to realize the full benefits that the industry offers. Businesses are increasingly been asked to shoulder responsibility for their social, ethical and environmental impact, with this pressure particularly keenly felt in consumer-facing industries (PWC, 2006).

One of the aftermaths of Enron’s collapse has been the emergence of best practices (e.g., Sarbanes-Oxley Act of 2002) to enhance and improve corporate governance and transparency. Corporate governance has been a dominant policy issue in both the developed and developing economies. In an era of increasing capital mobility and globalization, corporate governance has become an important framework condition affecting the industrial competitiveness of companies and is one key element of improving microefficiency (Maher and Anderson, 1999). The importance of corporate governance cannot therefore be overemphasized given the fact that shareholders typically face the problem of moral hazard and adverse selection in the face of separation of ownership and control (Berle and Means, 1932).

Value creation indeed has become a topical issue in modern management, and for any business to withstand the soaring competitive and unpredictable environment it must constantly assess its corporate governance strengths and weaknesses in that shareholders are increasingly becoming concerned about the long-term survival of firms. A system of corporate governance requires that a board of directors be accountable, while allowing the board to create wealth for the shareholders of the company.

But does anybody care about how the board is organized if the company is generating profit for its investors? Good corporate governance requires that a company is not run only in a profitable way but in an ethical and legal manner as well. Consolandi et al. (2006) contend that a system of corporate governance can be defined as a more or less country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that stakeholders exert on managerial decision-making. Thus, there is no single model of corporate governance and each country (industry) has through time developed a wide variety of mechanisms to overcome the agency problems arising from the separation of ownership and control (Maher and Anderson, 1999). Governance practices thus vary not only across countries but also across firms and industry sectors.

Despite the well developed literature on the impact of corporate governance on firm performance in the developed economies and lately developing countries such as Ghana (see Kyereboah-Coleman et al., 2005) empirical literature on the corporate governance practices of the hospitality industry remains very scanty. Most empirical literature in Ghana has considered only listed companies and
some SMEs but the hospitality industry is currently not captured by the Ghana Stock Exchange industry classification because none of the firms listed is in the hospitality industry.

In addition, the hospitality industry is being packaged by the government as the next major source of foreign exchange earner for the country. Given that no scientific study has been carried out in this area to ascertain the industry’s governance practices and also coupled with the fact that it is not one of the industries highly regulated by the government like the financial services industry, this paper seeks to ascertain the governance practices of the hospitality industry by comparing it to best practices around the world. Becht et al. (2002) identify a number of reasons for the growing importance of corporate governance, including the world-wide wave of privatization of the past two decades, the pension fund reform and the growth of private savings, the takeover wave of the 1980s, the deregulation and integration of capital markets, the 1997 East Asia Crisis, and the series of recent corporate scandals in the U.S. and elsewhere. This further augments the need for this study. The rest of the paper is divided into four sections. Section 1 reviews Ghana’s corporate governance framework; section 2 discusses the methodology and data used in the study. Section 3 contains the discussion of the results and the last section summarizes and concludes the paper.

1. Overview of governance framework in Ghana

Limited liability companies are regulated by the Companies Code, 1963 (Act 179). The legal/regulatory framework for corporate governance thus hinges on the Companies Code. In addition, the Securities and Exchange Commission provides corporate governance guidelines for the regulation of listed firms on the Ghana Stock Exchange. This is, however, not mandatory unlike the provisions of the Companies Code. There are other industry-specific regulations such the Banking Act, 2004 (Act 673) and the Insurance Law. The Securities Industry Law, 1993 (PNDC 333) as amended by the Securities Industry (Amendment) Act 2000, (Act 590), which also provides among other things for governance of all stock exchanges, investment advisors, securities dealers, and collective investment schemes licensed under the Securities & Exchange Commission (SEC). In addition to the above sources of regulation, there are other voluntary codes of good corporate governance including the Ghana Corporate Manual, Institute of Directors (Ghana) Code of Ethics for Directors and the Ghana Business Code.

1.1. Board of directors and its characteristics.

The Companies Code stipulates a minimum of two directors for each company with no ceiling on the maximum number. It, however, allows companies themselves to fix the maximum number of directors in their regulations whilst the Ghana Stock Exchange (GSE) Listing Regulations are silent on board size.

In terms of board composition, there is no requirement under the Companies Code for the appointment of independent directors neither is there a provision for the balance of executive and non-executive directors. However, there is allowance for the interests of different stakeholders to be represented on the board. This is however a requirement under the Securities and Exchange Commission’s Code of Best Practices on Corporate Governance (SEC Code) for the GSE. The Companies Code makes provision for the appointment of executive directors by allowing directors to hold concurrently with the office of director, any other office or place of profit in the company, except the office of auditor. In terms of board structure based on duality, the Companies Code does not prevent the appointment of the same person to the two offices.

The SEC Code, on the other hand, advocates for but does insist on the two-tier board structure where the CEO is different from the board chairman. Clearly the role of corporate governance in firm performance has been noted in the corporate sector in Ghana. The responsibility for good corporate governance at the firm level is placed on the Board of Directors. Under the companies Code, 1963, (Act 179), the business of a company is managed by the BOD except as otherwise provided in the company’s regulations. No doubt, the effectiveness with which the board plays its oversight role depends to a large extent on its membership, its independence, and its expertise. Under the Companies Code, the appointment and replacement of directors of companies are regulated by the company’s regulations and are the preserve of shareholders. Corporate bodies, adjudicated and undischarged bankrupts, and persons convicted on indictment in Ghana or elsewhere of any offence involving fraud, dishonesty, or any offence in connection with the promotion, formation or management of a corporate body are not competent to act as directors of companies.

1.2. Audit committee. It is increasingly becoming clear the need for the establishment of an audit committee. The Sarbanes-Oxley Act makes it compulsory for the establishment of such a committee. Indeed the role of the board in financial controls is seen as ineffective without an audit committee of the board. Though, the Companies Code has no
requirement for the establishment of such a committee, the GSE Listing Regulations recognize the need for such a committee. A company seeking to list on the GSE must attach to its application, written evidence regarding the operation and effectiveness of an audit sub-committee of that company’s board of directors covering a period prior to the application, as the GSE may prescribe.

The Listing Regulations provide that the audit sub-committee shall as far as possible be composed of the company’s non-executive directors. The GSE Listing Regulations prescribe the following terms of reference for audit committees:

- to make recommendations to the board concerning the appointment and remuneration of external auditors;
- to review the auditor’s evaluation of the system of internal control and accounting;
- to review and discuss the audited accounts with the auditors and call for further information from the auditors or management;
- to review the scope and effectiveness of the internal audit procedures in consultation with the chief internal auditor, director of finance or their equivalents, however designated in the particular company and the external auditors; and to consider and make recommendations on the conduct of any aspect of the business of the company that the GSE believes should be brought to the attention of the board.

1.3. Auditors. The Companies Code enjoins directors to at least annually (at intervals of not more than 15 months) prepare and send to each member and debentureholder of the company a profit and loss account and balance sheet and directors’ and auditors’ report.

These documents will be presented to shareholders at the Annual General Meeting. The GSE Listing Regulations require more frequent disclosure from listed companies. Listed companies must provide the GSE with a half-yearly report as soon as figures are available (not later than three months after the end of the first half-yearly period in the financial year) and a preliminary financial statement as soon as figures are available (not later than three months after year-end).

According to the Companies Code, 1963 (Act 179), the ultimate responsibility for the preparation of the financial statements rests with the board and cannot be delegated to the auditors. The Law requires that before the commencement of business the company should have auditors. Under the companies’ code, the auditors of a company stand in a fiduciary relationship to the members of the company as a whole and should act in a way faithful, diligent, careful, and ordinarily skilful auditors would act in the circumstances. Auditors are required, among other things, to report to shareholders their opinion as to the adequacy of information obtained on the company and whether the company’s accounting books have been kept properly.

Under the Companies Code (section 296), auditors must be licensed and practicing chartered accountants, and must not be infants; persons found by competent courts to be of unsound mind; undischarged bankrupts; or persons convicted of offences involving fraud, dishonesty, or any offence in connection with the promotion, formation or management of a body corporate, or of any fraud or breach of duty in relation to a body corporate. Auditors are appointed by an ordinary resolution of shareholders, except that directors may appoint first auditors and fill any casual vacancy in the office of an auditor. To promote auditor independence, the Companies Code disqualifies persons who are officers of the company or associated companies, partners of, or employees of an officer of the company or of an associated company, from holding office as auditors.

However, the code permits auditors, in addition to their statutory duties to shareholders as auditors, to provide other services to the company such as “advising on accounting, costing, taxation, raising of finance and other matters”. This provides fertile ground for conflict of interest situations, which will compromise their role as independent statutory auditors. Under the Companies Code, auditors once appointed are to continue in office until they cease to be qualified for appointment as auditors. At this point they must resign their office by presenting a notice in writing to the company, or they can be removed by an ordinary resolution of shareholders at an annual general meeting after three- to five - day notice to the auditor. The auditor is required to respond to the intention to remove him and must be allowed to speak to this at the annual general meeting. No provisions exist under the Companies Code limiting the term of office of auditors.

However, Standards of corporate governance should be applied to ensure adequate protection of the interests of all shareholders, regardless of the size of their holdings. The greater the level of shareholders’ protection achieved, the more investment capital will be available to the companies which will favorably influence the Ghanaian economy as a whole.

Standards of corporate governance should be instrumental to the attainment of high ethical stan-
standards in relations between market participants. Also, Ethical standards of corporate governance form sustainable behavioral patterns common to all participants in corporate relations. Compliance with these standards is not only a moral imperative; it also helps the company avoid risks, supports long-term economic growth and facilitates successful business activity. It must be emphasized that high standards of corporate governance cannot be assured by legislative provisions alone but companies should act in accordance not only with statutory standards, but also with ethical standards which are often more demanding than the law’s requirements. Ethical standards present a set system of behavioral norms and customs of the trade traditionally applied by the business community, which are not based on the law, and which form positive expectations with respect to the anticipated behavior of participants in corporate relations as found in the Russian economy.

2. Research methodology

The methodology assumed for this study is scientific as the process is systematic, methodological, rigorous, conventional and unbiased. This is to ensure the gathering of relevant and reliable data and the application of appropriate statistical techniques in the analysis of the data in order to control potential statistical errors and thereby arrive at accurate conclusions. The study employs primary data derived basically through the administration of questionnaires and interviews to elicit responses on corporate governance practices in the industry. The questionnaires included both open and close-ended questions. Mostly the open-ended questions enable respondents to express their views on some issues under consideration in their own way thus allowing for flexibility and freedom (Hakim, 1987 and Fink, 1995). The personal interview was a purposeful discussion in line with Kahn and Camel (1957).

The sample was drawn from the list of registered companies in the hospitality industry published by Ghana Tourism Board as at the end of 2007. The companies have been grouped according to the quality of service provided and standards of their rooms into ‘stars’. In all, ten companies were selected with five of them 4-star companies and the remaining 3-star companies. The study then compares the governance systems of the two classes to ascertain whether these classes exhibit similar or different governance systems. The paper further analyzes the results in the context of best governance practices around the globe.

3. Data presentation and analysis

This section presents the analysis of the governance structures of the hospitality industry. Governance elements including board size, board composition, CEO duality, board appointment, audit committee characteristics and external auditor appointment are also analyzed. Finally, we contextualized the findings in the light of internationally best practices of good governance.

3.1. Governance structure of the hospitality industry. In terms of ownership structure, 60% of the 3-star hotels are wholly owned Ghanaian companies, 20% are joint ownership with majority (Ghanaian shareholding), and other 20% are joint ownership with majority (foreign shareholding). For the 4-star hotels, 40% of the companies are joint ownership with majority (foreign shareholding), other 40% of the companies with majority (Ghanaian shareholding) and remaining companies being wholly owned Ghanaian companies (see the table below).

Table 1. Ownership structure of companies

<table>
<thead>
<tr>
<th>Ownership structure</th>
<th>3-Star</th>
<th>4-Star</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholly owned Ghanaian companies</td>
<td>60%</td>
<td>20%</td>
</tr>
<tr>
<td>Joint ownership with majority Ghanaians</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Joint ownership with majority foreign holding</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Wholly owned foreign companies</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Authors’ compilation, 2008.

3.2. Existence of board of directors. The board of directors (BOD) is central to the link between corporate governance and performance of the management. Jensen (1983) contends that the ostensible role of the BOD is to provide high-level counsel and oversight to the management. The Companies Code, 1963 (Act 179) requires companies incorporated under the code to have board of directors. All the companies have board of directors with varying board size. 4-star hotels have average board size of seven whilst 3-star hotels have average board size of six. There are however wide variations in these numbers between the cross-sections with a minimum board size of three for 3-star companies and 4 for 4-star companies.

All companies sampled have met the minimum Companies Code provision on the number of directors a company must have at all times even though SEC Guidelines recommend a board size of between 8 and 16. But the SEC guidelines do not necessarily apply to these companies since they are not listed firms. Best corporate governance practices recommend the importance of having the right quality and experience of independent directors on the board than sheer numbers of individuals on the board.
According to Lipton and Lorsch (1992), firm performance is believed to be improved by limiting the board size because the benefits of increased monitoring that larger boards gain are outweighed by the poorer communication and decision-making of larger groups (see also Jensen, 1993). Too big a board is likely to be less effective in substantive discussion of major issues (Lipton and Lorsch 1992, and Jensen 1993) and suffer from free-rider problems among directors in their supervision of management (Hermalin and Weisbach, 2001). However, a larger board may be more valuable for the breath of its service as suggested by Chaganti et al. (1985).

3.2.1. Board independence. Independent directors tend to play an active and often valuable role (Brickley and James, 1987, and Jonovic, 1989). It is recommended that a firm puts up a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties. Board independence is widely held as a ‘lighthouse on a dark and stormy night’. 60 percent of the directors are non-executive directors in the case of 3-star hotels whilst 80 percent of the directors in the case of 4-star hotels are non-executive directors. All the boards sampled are thus independent and this is quite encouraging as the trend now is to have more non-executive directors. The Higgins Report (2003) UK requires that at least half of the board must be independent whilst the US Conference Board (2003) holds that a substantial majority of the board should be non-executives (see also South Africa King’s Report, 2003 and OECD Principles, 1999). Baysinger and Butler (1985) and Rosenstein and Wyatt (1990) have also shown that the market rewards firms for appointing outside directors. But Donaldson and Davis (1991) noted that whilst outside directors bring a breadth of knowledge and expertise to the firm, they may have a limited understanding of the firm’s business, which would impede their ability to guide and supervise the management, and could even stifle strategic action and result in excessive monitoring.

3.2.2. Frequency of board meetings. A board that fails to hold regular meetings runs the risk of being unable to fulfill its responsibilities to the shareholders, the company and other stakeholders. In the case of 4-star hotels, boards meet quarterly, whilst there are variations with 3-star hotels. The average frequency of board meeting is twice in a year for 3-star hotels. Best practice recommends that the frequency of meetings will depend on the company’s situation and on internal and external events and circumstances. Daily meetings may need to be held on exceptional circumstances. As a general rule, full board meetings should be no less than quarterly and quite possibly monthly. In all cases, the chairman of the board exercises the ultimate responsibility, planning and running board meetings. It is the chairman who sets the corporate agenda consistent with the recommendations of Dulewicz et al. (1995).

3.2.3. Board chairman/CEO duality. Jensen (1993) recommends that the function of the CEO could be separated from the functions of the board chairman. This ensures that there are checks and balances on the powers of the CEO. Organizational theories also suggest that “the CEO duality” (CEO is also the board chairman) diminishes board control and promotes CEO entrenchment (Hambrick and Finkelstein, 1987). Fama and Jensen (1983) also argue that concentration of decision management and decision control in one individual reduces board’s effectiveness in monitoring top management. It has been noted though that, the one-tier board structure type that is where the board chairman is the same as the CEO leads to leadership facing conflict of interest and agency problems (Berg and Smith, 1978; Brickley et al., 1997) thus giving preference to the two-tier system where there is a separation. 80% of the 3-star hotels operate the one-tier board topology where the board chair person is the same as the CEO with only 20% operating the two-tier system. In the case of 4-star hotels, majority (60%) operate the two-star system with only 40% practicing the one-tier system. Yermack (1996) argues that firms are more valuable when the CEO and board chair positions are separate but the situation in the case of 3-star hotels is inconsistent with best practice.

3.2.4. Audit committee and its composition. Even though, it is not a requirement for companies to have audit committees, the SEC guidelines and international best practice enjoin companies especially publicly traded firms to have audit committees composed solely of non-executive directors. The Sarbanes-Oxley Act of 2002 makes it compulsory for the establishment of such a committee. An audit committee typically consists of three to five members and the members should meet minimum financial literacy standards, and at least one of the committee members should have an accounting or financial management expertise (BRC, 1999). 60% hotels in the 3-star category do not have audit committees whilst 80% of the boards in 4-star category have audit committees. But the composition of some of the audit committees does not meet best practices. 40% of the boards that have audit committees have the CEO as the chair person and some of them are also made up of executive direc-
tors. The audit committees have average size of three but qualification and area of specialization were not investigated.

3.2.5. Board evaluation and other matters. Best corporate governance practices recommend the need for the company to evaluate the board’s performance. Again, in the case of 3-star hotels, majority (60%) do not evaluate the board’s performance whilst only 20% do evaluate the board’s performance. 20% of the respondents however did not answer this question. 80% of the respondents in the case of 4-star hotels do evaluate the board’s performance on periodic basis. 20% of the respondents however do not evaluate the board’s performance. Respondents were also asked whether board members have retiring age. In all the cases, majority (60%–3-star hotels and 60%–4-star) do not have retirement age for the directors. Directors qualify for reappointment in the case of the hotels with retirement age or end of their appointment.

3.2.6. Auditors. The Companies Code, 1963 (Act 179) enjoins companies to have auditors. In all the cases, the companies have met this requirement under the law. Even though, all the companies have external auditors, they are not rotated in line of best practices. 40% of the respondents in all cases affirm that external auditors perform other non-audit services to them for a fee such as accounts preparation and tax services. 80% of the hotels in all the cases have internal auditors appointed by management but 40% of the internal auditors in the case of 3-star hotels report to the CEO and management and not necessarily the audit committee, whilst only 20% in the case of 4-star hotels report to management including the CEO. But internal audit independence is achieved when the internal auditors report to the audit committee of the company instead of the CEO or management.

Conclusions and recommendations

The study evaluates the governance practices of Ghanaian hospitality industry. Good corporate governance has become a topical issue today because it has become part of the larger economic context in which businesses operate. Despite the growing importance of corporate governance all over the world, there is no single model of corporate governance and each country (industry) has with time developed a wide variety of mechanisms to overcome the agency problems arising from the separation of ownership and control. The hospitality industry is viewed as a major foreign exchange earner for the country but little is known about their governance practices given the high standards expected of companies in this industry. It is in line with this research gap that this study is undertaken.

The governance variables considered in this paper include the board size, board composition, board chairman/CEO duality, audit committee characteristics and audit matters. In all, ten companies were sampled drawn from the official publication of Ghana Tourism Board. The companies are classified into stars. The study thus considered the governance practices of 3-star and 4-star companies. Their governance practices were compared to each other and also to best practices around the world.

It was discovered that, all the companies have boards of directors with variations in the membership. All the companies have board size of more than two thus meeting the minimum requirement of the Companies Code. 4-star hotels appear to have more board members than 3-star hotels even though the variations are not so much. 60% of the boards in the case of 3-star and 80% in the case of 4-star are independent in line of best practice. Majority of the board members are non-executive directors.

But some of the companies in both cases are operating the one-tier system of corporate governance where the board chairman is the same as the CEO. This is in contravention of best practices. Even though, the Companies Code is silent on the CEO duality, best practices of corporate governance all over the world recommend the separation of the functions of CEO from the board chair person. Again, even though, it is not a legal requirement under the code to have audit committees; some of the companies have audit committees even though the composition of the committees does not meet best practices. Some of the committee members are executive directors and in some cases the CEO is the chairman of the committee.

All the companies have appointed external auditors in fulfillment of the requirement of the Code provisions. Internal auditing has become an important component of risk management and it was discovered that majority of the companies have internal auditors. But in some cases, the internal audit department reports to the CEO instead of the audit committee. Good corporate governance requires the internal audit department reports to the audit committee to ensure their independence. It is recommended that the Companies Code should be reviewed to reflect practices of corporate governance currently.

The Companies Code should be reviewed to require the establishment of audit committees of boards to provide for sanctions for unauthorized payments by companies and also to provide sanctions for poor audits by external auditors. The
audit committees must be well constituted with solely non-executive directors and at least one of the committee members must meet some minimum financial literacy standard. Audit rotation must be adopted to prevent familiarity threat to audit independence.

It is also important for the companies to continuously improve upon their corporate governance practices to provide the climate conducive for orderly development of the hospitality industry and to attract investors. Any improvement must ensure the separation of the functions of the CEO from the board chair person.

References