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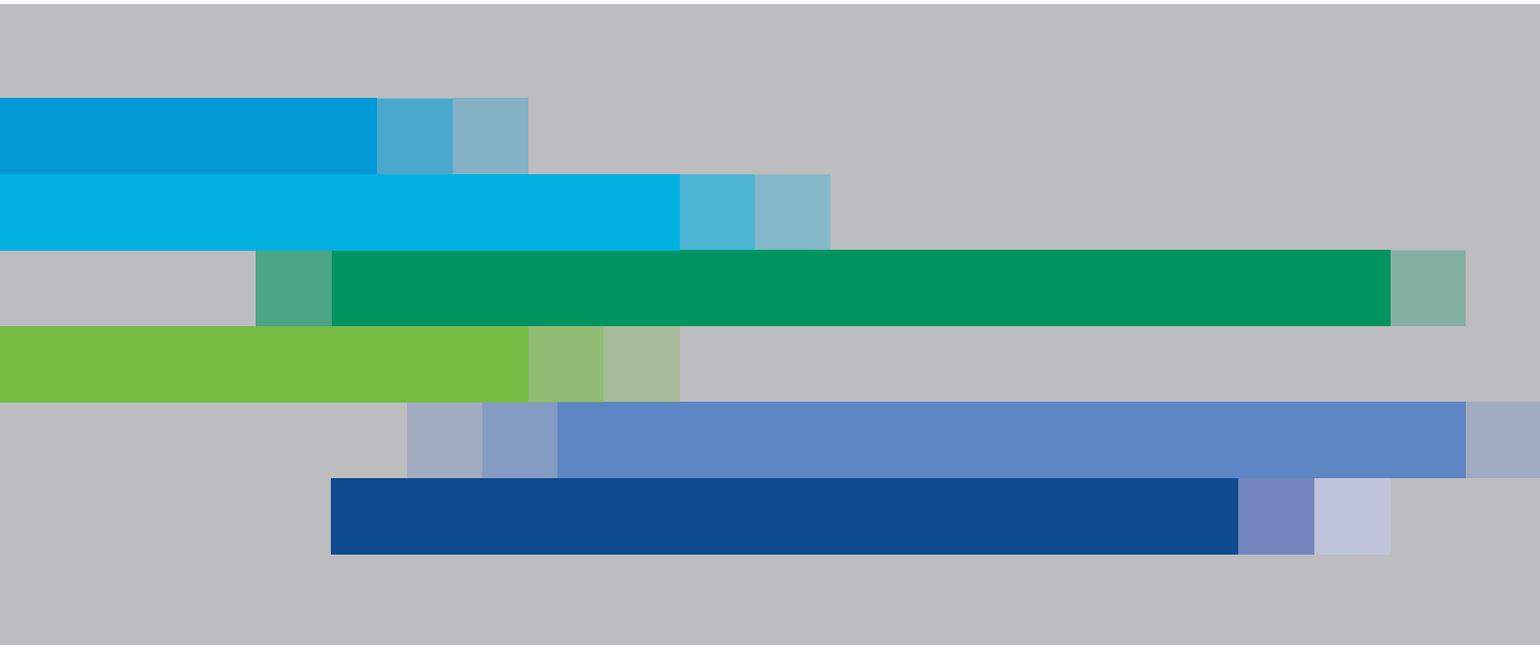
**CFA INSTITUTE
AFRICAN ADVOCACY COUNCIL**

WHAT'S YOURS IS MINE AND WHAT'S MINE IS MINE

**AN EXAMINATION OF THE HARM CAUSED BY
NON-COMPLIANT RELATED PARTY TRANSACTIONS
ON THE LUSAKA SECURITIES EXCHANGE AND
A PROPOSAL TO MITIGATE THIS HARM**

July 2022

**SUMEET JAIN AND
GODFREY MWANZA, CFA**



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Related Party Transactions on the Lusaka Securities
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Sumeet Jain and
Godfrey Mwanza, CFA

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OPENING REMARKS FROM THE AFRICAN ADVOCACY COUNCIL

The CFA Institute African Advocacy Council ("AAC") is a collaborative forum comprising policy and research leaders from CFA societies located in sub-Saharan Africa: CFA Society East Africa, CFA Society Ghana, CFA Society Nigeria, CFA Society Mauritius, and CFA Society South Africa. It was launched in 2021 to bring together expert voices from our network of members in sub-Saharan Africa interested in advancing the development of capital markets in their region. The body is tasked with researching the key policy changes, economic developments, and professional practices that are impacting the region's investment industry, with a view to advocating for investor protection, capital market integrity, and ethical behavior.

The AAC is proud to be associated with the authors in the publication of this article. The AAC's mission is to support the creation and adoption of rules and regulatory standards that improve market structure, transparency, and fairness for investors in African capital markets. The objective, findings, and proposals of this article strongly align with the AAC's mission.

We believe the analytical approach in this article is original for two reasons:

1. It presents a cogent argument firmly grounded in the law and finance of related party transactions ("**RPTs**"); and
2. It examines RPTs in an overlooked market. Most RPT research is focused on Asia, Europe, India, and the Middle East and North Africa. This research, using Zambia as a specific case, now presents an African point of view.

We think this article will be most useful to practitioners who are in a position to facilitate positive change in the capital markets. Specifically, the target audience for this article includes:

- Policymakers and regulators: senior management at the Ministry of Finance, the Securities and Exchange Commission, and the Lusaka Securities Exchange;
- Publicly listed companies: CEOs, CFOs, and legal officers at publicly listed companies; and
- Investors: Investment professionals and portfolio managers at institutional investors.

We trust investment professionals will be interested in the literature review and technical analysis of the issues raised in this article as well as the proposed policy recommendations. High-quality financial analysis based on meaningful and representative corporate information is the bedrock of sound capital market development.

We hope this article generates positive developments in corporate governance in the Zambian capital markets. We also wish that such work opens the floor for evidence-based debate about issues concerning the capital markets in Zambia and other African countries.

FOREWORD

During his inaugural speech to Parliament in September 2021, the President of Zambia, Hakainde Hichilema, assured both local and international markets that his administration will ensure “that confidence is restored in the markets” through the creation of an enabling environment that will allow business to thrive. To realise that goal, the new administration is currently exploring the best ways to bring back the lost confidence in the market through legislative, regulatory, and administrative changes that support business growth and consolidation. In the local capital market, this restoration of confidence entails the creation of a level playing field whereby domestic and foreign players are assured of not only the security of their investments but also fair competition.

This article speaks directly to the new administration’s declared wish for “clean business” through the curbing of the high prevalence of related party transactions (“**RPTs**”) on the Lusaka Securities Exchange. The aim is to ensure that all players comply with the country’s securities law. Currently, the existence of high levels of non-compliant RPTs calls for, among other things, the strengthening of monitoring and enforcement capacity of government institutions that are in charge of the regulation of local capital markets. Compliance by the average market player in Zambia clearly requires improvement as part of the enhancement of good corporate governance. Such compliance is essential, as such a move would secure better functioning local capital markets that are so essential for fostering a robust investment climate.

In the light of the above points, it is my hope that this insightful article that makes a compelling case for significant reforms will contribute positively to good corporate governance in Zambia’s capital markets.

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EXECUTIVE SUMMARY

This article seeks to curb the prevalence of non-compliant related party transactions ("**RPTs**") on the Lusaka Securities Exchange ("**LuSE**") by increasing awareness of such RPTs, examining the harm that they inflict, and proposing actions to mitigate this harm.

Key Findings

- RPTs are prone to abuse in the absence of adequate governance. When abused, controlling shareholders use RPTs to show excessive expenditure on a company's income statement, ultimately with the aim of (1) avoiding corporate taxation through transfer pricing and/or (2) usurping the investment returns of minority shareholders.
- Zambian securities law provides a sound framework for the governance of RPTs. It defines RPTs broadly to cover a range of transaction types, requires issuers to disclose comprehensive information about RPTs, and establishes an approval process for issuers to engage in RPTs.
- Yet, many issuers listed on the LuSE consistently engage in RPTs without fulfilling the approval process beforehand. In 2020, 12 of 20 issuers listed on the LuSE engaged in non-compliant RPTs. The total expenditure under these non-compliant RPTs amounted to 3.8 billion Zambian kwacha ("**ZMW**") in 2020.
- Non-compliant RPTs potentially inflict major and widespread harm on stakeholders across the Zambian economy. Such transactions improperly divert away an estimated ZMW 0.6B to ZMW 1.9B from the Zambian economy each year.

Key Proposals

Addressing the harm of non-compliant RPTs requires stakeholders in Zambian capital markets to take actions aimed at seeking redress for such RPTs in the past and deterring such RPTs in the future:

- Regulatory authorities should intensify monitoring and enforcement of issuers' compliance with regulations governing the disclosure and approval process for RPTs.
- Issuers' managers and directors should develop a clearer understanding of regulations governing RPTs and drive issuers' compliance with these regulations.
- Minority shareholders should take an active role in monitoring issuers' RPTs and advocating for improved transparency and fairness.
- Proxy advisors should consider advising institutional investors in Zambian and other African capital markets on issues affecting equity performance, including RPTs.

Introduction

Sir Adrian Cadbury, former chairman of Cadbury Schweppes, cautioned that “corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals.”¹ Unfortunately, the prevalence of related party transactions (“RPTs”) that do not comply with local securities law upsets this delicate balance on the Lusaka Securities Exchange (“LuSE”).

This article seeks to curb the prevalence of such non-compliant RPTs on the LuSE by increasing awareness of these RPTs, examining the harm that they inflict, and proposing actions to mitigate this harm. To that end, **Section 1** of this article points out that RPTs are prone to abuse in the absence of adequate governance. **Section 2** explains that Zambian securities law, in fact, provides a sound framework for the governance of RPTs, in large part by establishing an approval process for issuers to engage in RPTs. Yet, as **Section 3** shows, many issuers listed on the LuSE consistently engage in non-compliant RPTs without fulfilling the approval process beforehand. **Section 4** estimates that non-compliant RPTs on the LuSE inflict major and widespread harm on stakeholders across the Zambian economy. Finally, **Section 5** proposes that to address the harm of non-compliant RPTs, stakeholders in Zambian capital markets need to take actions aimed at seeking redress for such RPTs in the past and deterring such RPTs in the future.

1. RPTs Are Transactions That Can Be Beneficial for Companies But at the Same Time Are Prone to Abuse in the Absence of Adequate Governance

According to International Accounting Standard 24 (“IAS 24”), RPTs are transactions where there “is a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged.”² RPTs are commonly used by companies transacting with their corporate group for the purpose of procuring raw materials, purchasing management services, securing licenses to use brands, obtaining financing and paying interest thereunder, or selling end products.

As evident, RPTs may be beneficial for companies in realising synergies through vertical or horizontal integration with their corporate group. Specifically, RPTs may contribute to reducing transactional costs and improving enforcement of contractual rights.³

At the same time, RPTs are prone to abuse in the absence of adequate governance. When abused, controlling shareholders force companies into inefficient RPTs (1) at inflated pricing or (2) to procure superfluous goods or services.⁴ Such inefficient RPTs are used by controlling shareholders to show excessive expenditure on a company’s income statement, ultimately with the aim of (1) avoiding corporate taxation through transfer pricing and/or (2) usurping the investment returns of minority shareholders. Indeed, some of the most prominent corporate governance scandals across the world have involved the abuse of RPTs, as was the case at Enron (see **Exhibit 1**).

¹Cadbury (2000).

²IAS 24.9.

³Loon and De Ramos (2009).

⁴Loon and De Ramos (2009).

EXHIBIT 1. "THE FOX IN THE HENHOUSE": THE ROLE OF RPTs IN ENRON'S DOWNFALL

Facts	<ul style="list-style-type: none">• Enron Corporation ("Enron") was an energy marketing, distribution, and trading company that was in operation between 1985 and 2001• Enron was headquartered in Houston, Texas, and listed on the New York Stock Exchange• Andrew Fastow ("Fastow") was Chief Financial Officer of Enron between 1990 and 2001• Fastow established two investment companies in 1999: LJM Cayman, L.P. and LJM2 Co-Investment, L.P. (together "LJM Entities"), named after his wife and sons (Lea, Jeffrey, Matthew)• Fastow secured institutional investors for the LJM Entities, managed the LJM Entities as general partner and earned management fees, and made investments in projects developed by Enron
Allegations	<ul style="list-style-type: none">• The U.S. Securities and Exchange Commission brought a complaint in 2002, alleging Fastow used transactions with the LJM Entities to fraudulently manipulate Enron's financial statements and to generate profits in the LJM Entities<ul style="list-style-type: none">– Enron sold assets to the LJM Entities to artificially inflate earnings around reporting periods– Enron, at the same time, entered into secret side agreements to later buy back these assets at terms that guaranteed a profit to the LJM Entities– Fastow benefited from the profits generated in the LJM Entities
Outcome	<ul style="list-style-type: none">• Fastow pled guilty to conspiracy to commit securities fraud in 2004, admitting he used RPTs to fraudulently manipulate Enron's financial statements and to enrich himself at the expense of Enron's shareholders• Fastow was sentenced to 6 years in prison and forfeited over US\$20M in 2006
Aftermath	<ul style="list-style-type: none">• Enron filed for bankruptcy in 2001• Arthur Andersen, Enron's auditor, was convicted of obstruction of justice in 2002, and subsequently surrendered its CPA license and filed for bankruptcy• The U.S. Congress passed the Sarbanes-Oxley Act in 2002, introducing stricter controls around corporate disclosure and audits

Sources: US SEC Complaint against Andrew Fastow (2002); US DOJ press release about Andrew Fastow's guilty plea (2004); US DOJ press release about Andrew Fastow's sentencing (2006); "Bad Bets" (2021).

2. Zambian Securities Law Provides a Sound Framework for the Governance of RPTs

The Harmonised Listings Requirements of the Lusaka Stock Exchange LuSE ("**LuSE Regulations**") aptly define RPTs broadly to cover a range of transactions, require issuers to disclose comprehensive information about RPTs, and establish an approval process for issuers to engage in RPTs.⁵ Beyond that, the Zambian Companies Act of 2017 ("**Companies Act**") echoes the LuSE Regulations with instructions on the conduct of directors engaging in transactions with a company.

⁵The key elements of a governance framework for RPTs include definition, disclosure, approval process, and sanctions. OECD (2012), p.21, available at <https://www.oecd.org/daf/ca/50089215.pdf>.

2.1. The LuSE Regulations define RPTs broadly to cover a range of transaction types and a range of parties

In line with the widely accepted definition of RPTs in IAS 24, the LuSE Regulations define RPTs to be “transactions with parties related to an issuer.”⁶

As such, RPTs cover a range of transaction types, including but not limited to: (1) purchases or sales of goods, (2) purchases or sales of property and other assets, (3) rendering or receiving of services, (4) leases, (5) provision of guarantees or collateral, and (6) transfers under finance agreements.

Furthermore, RPTs include transactions involving a range of counterparties. Section 10.1(b) of the LuSE Regulations defines “related party” to include (1) a material shareholder of the issuer, (2) a current or recent director of the issuer, (3) a current or recent advisor to the issuer, (4) a current or recent executive officer of the issuer, and (5) an associate of any of the aforementioned related parties.

By the same token, the scope of RPTs extends to transactions involving members of the issuers’ corporate group. As laid out under Section 10.1(a) of the LuSE Regulations, RPTs include transactions involving an issuer or a subsidiary of the issuer.

2.2. The LuSE Regulations require issuers to disclose comprehensive information about RPTs and further authorise the LuSE to compel such disclosure from non-compliant issuers

The LuSE Regulations place a continuing obligation on issuers to disclose comprehensive information about RPTs. Section 3.19 of the LuSE Regulations requires issuers to submit timely annual financial statements. According to Section 8.62 of the LuSE Regulations, these annual financial statements must “be prepared in accordance with International Financial Reporting Standards.” One such standard, IAS 24, requires comprehensive disclosure of all RPTs entered into by an issuer, including but not limited to (1) the amount of each transaction, (2) the outstanding balance in each transaction, and (3) the terms, conditions, and guarantees of each transaction.⁷

As a failsafe measure, the LuSE has authority to compel issuers to comply with disclosure obligations, including those pertaining to RPTs. Section 8.65 of the LuSE Regulations introduces a panel (“**GAAP Monitoring Panel**”) to advise the LuSE on whether issuers are complying with international accounting standards. After receiving advice from the GAAP Monitoring Panel, the LuSE has discretion to (1) instruct non-compliant issuers to publish information that the LuSE deems appropriate and (2) censure non-compliant issuers.

⁶LuSE Regulations, Section 10.

⁷IAS 24.18–24.19.

2.3. The LuSE Regulations establish an approval process for issuers to engage in RPTs, under which the rigour of requirements applied to an RPT is proportional to its materiality to the issuer

At the outset, an issuer contemplating a transaction must determine whether the transaction constitutes an RPT. Where there is ambiguity, Section 10.2 of the LuSE Regulations allows for the issuer to consult with the LuSE to appropriately classify the transaction.

Next, once the transaction at hand is classified as an RPT, the issuer must assess the materiality of the RPT to its business. To make this assessment, the issuer must calculate the ratio of consideration earned by a related party under the RPT to the market capitalisation of the issuer ("**RPT Ratio**"). When calculating the RPT Ratio, Section 10.8 of the LuSE Regulations requires aggregation of the consideration earned by the same related party or any of its associates across all RPTs with the issuer within a 12-month period.

Thereafter, the issuer must categorise the RPT at hand based on its RPT Ratio as either:

- **Exempt RPT:** Under Section 10.6 of the LuSE Regulations, where the RPT Ratio is less than or equal to 0.25%, the transaction is not regarded as an RPT and is exempt from all requirements;
- **Small RPT:** Under Section 10.7 of the LuSE Regulations, where the RPT Ratio exceeds 0.25% but is less than or equal to 5%, the transaction is regarded as a Small RPT and is subject to abbreviated requirements; or
- **Large RPT:** Under Section 10.4 of the LuSE Regulations, where the RPT Ratio exceeds 5%, the transaction is subject to all the usual requirements of an RPT.

Finally, the issuer must comply with the requirements applied to the RPT at hand before engaging in the transaction (see **Exhibit 2**).

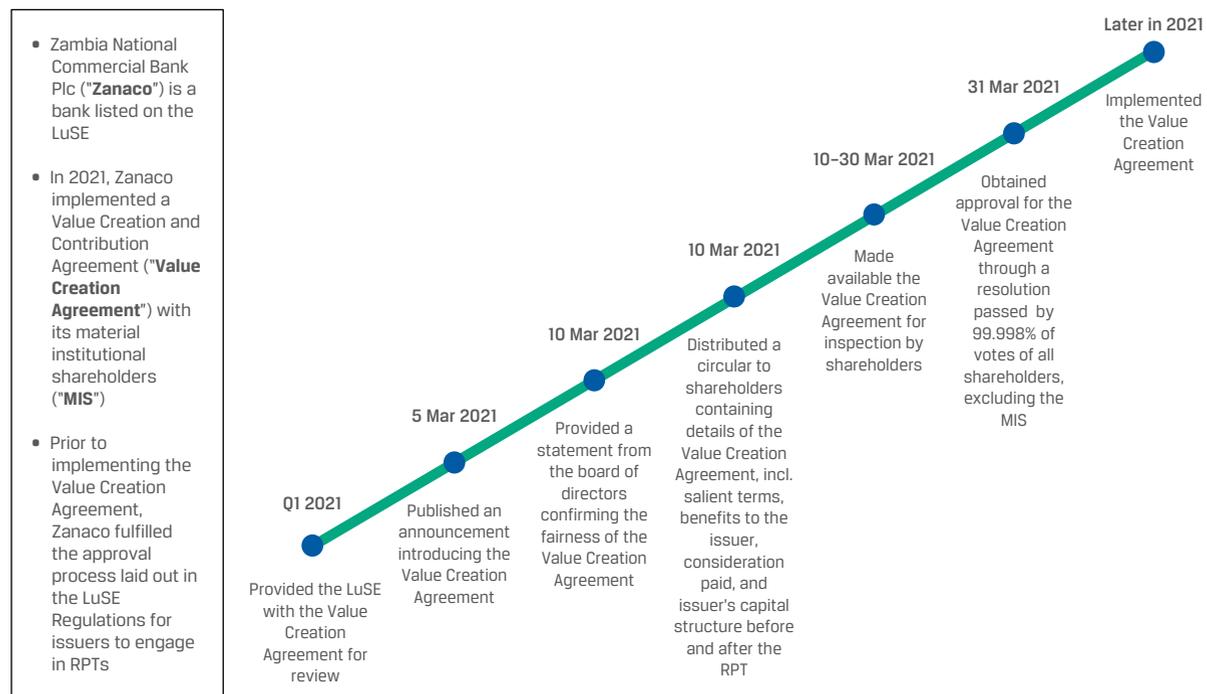
EXHIBIT 2. REQUIREMENTS FOR ENGAGING IN RPTs

	LuSE Regulation	RPT Ratio	Key Requirements before Engaging in RPT
Exempt RPT	Section 10.6	≤0.25%	<ul style="list-style-type: none"> • None
Small RPT	Section 10.7	>0.25% and ≤5%	<ul style="list-style-type: none"> • Inform the LuSE in writing of the details of the RPT • Provide the LuSE with written confirmation from an independent professional expert that the terms of the RPT are fair • Publish an announcement containing details of the RPT
Large RPT	Section 10.4	>5%	<ul style="list-style-type: none"> • Provide the LuSE with the underlying agreement of the RPT • Publish an announcement containing details of the RPT • Provide a statement from the board of directors confirming the fairness of the RPT • Distribute a circular to shareholders containing exhaustive details of the RPT • Obtain approval for the RPT through a resolution passed by a majority of votes of all shareholders, other than the related party and its associates*

*Approval for RPTs by a majority of non-interested shareholders ("**Majority of Minority Approval**" or "**MoM Approval**") is a potent procedural safeguard against abusive RPTs. Therefore, an increasing number of jurisdictions require MoM Approval, including the United Kingdom, South Africa, India, Hong Kong SAR, mainland China, Canada, and Australia. OECD, Corporate Governance Factbook (2021), Table 3.8.

Local experience suggests that it takes issuers approximately three months to complete the approval process for Large RPTs (see **Exhibit 3**).

EXHIBIT 3. APPROVAL PROCESS FOR RPTs IN ACTION



Sources: Zanaco Circular on Value Creation and Contribution Agreement (2021); Zanaco Minutes from AGM (2021).

2.4. The Companies Act echoes the LuSE Regulations with instructions on the conduct of directors engaging in transactions with a company

The Companies Act places overarching fiduciary duties on directors to “promote the success of the company,” to “exercise independent judgment,”⁸ and to “act in good faith and in the best interests of the company.”⁹ To successfully execute these duties in the context of RPTs, the Companies Act provides instructions on the conduct of directors engaging in transactions with a company. Section 107 of the Companies Act requires directors to avoid situations in which the director has an interest that conflicts with the interests of the company. Furthermore, Section 110 of the Companies Act requires directors to disclose their interest in a transaction or proposed transaction with the company to the board of directors.

⁸Companies Act, Section 106(c).

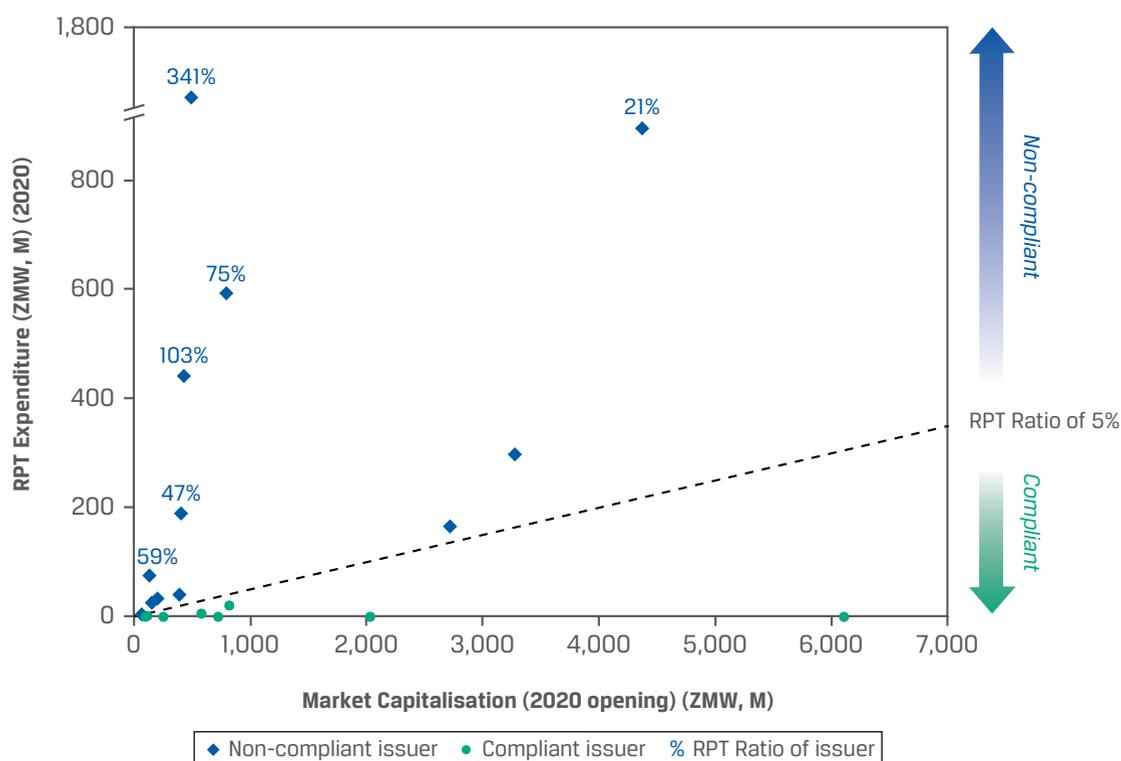
⁹Companies Act, Section 105(c).

3. Many Issuers Listed on the LuSE Consistently Engage In Non-Compliant RPTs

In 2020, 12 of 20 issuers listed on the LuSE engaged in Large RPTs without fulfilling the approval process beforehand (see **Exhibit 4**). During the same period, issuers listed on the LuSE had total RPT expenditure of ZMW 4.5B, of which ZMW 3.8B was non-compliant RPT expenditure, meaning that the expenditure exceeded the threshold RPT Ratio of 5% for Large RPTs and was made without fulfilling the approval process beforehand (see **Exhibit 5**). This pervasive non-compliance with regulations governing the approval process for RPTs is symptomatic of the fact that, as the World Bank noted back in 2006, “there is very limited awareness of these provisions, and they do not appear to be enforced.”¹⁰

EXHIBIT 4. RPT RATIOS OF ISSUERS LISTED ON THE LUSE (2020)

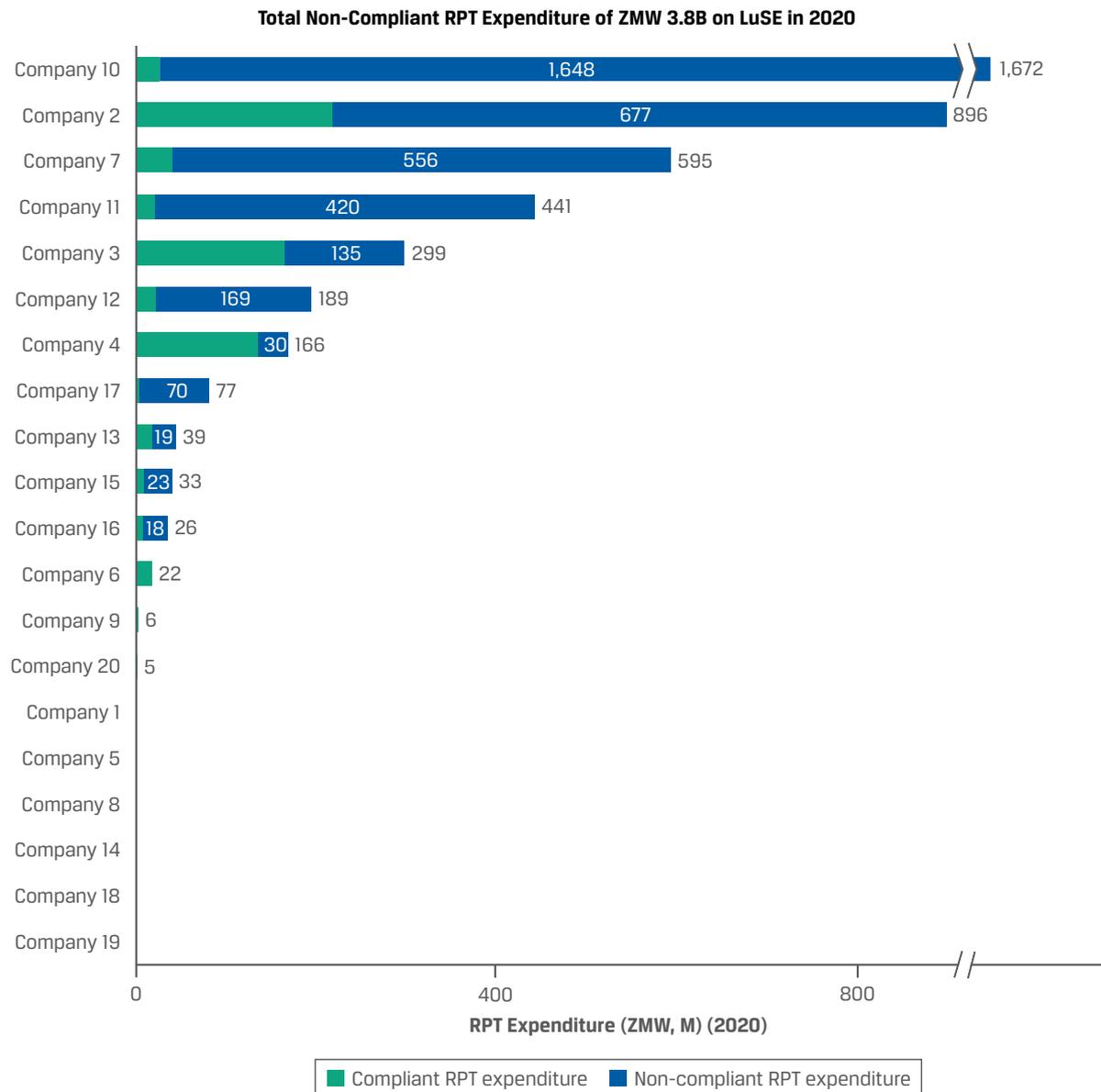
12 of 20 Issuers Listed on LuSE Engaged in Non-Compliant Large RPTs in 2020



Note: Data for the following companies are based on their latest disclosures: Company 1 (2019), Company 16 (2018), Company 18 (2019).
Sources: Company annual reports (2020); LuSE trade summaries (2019–2020).

¹⁰World Bank (2006), p. 3.

EXHIBIT 5. RPT EXPENDITURE BY ISSUERS LISTED ON THE LUSE (2020)

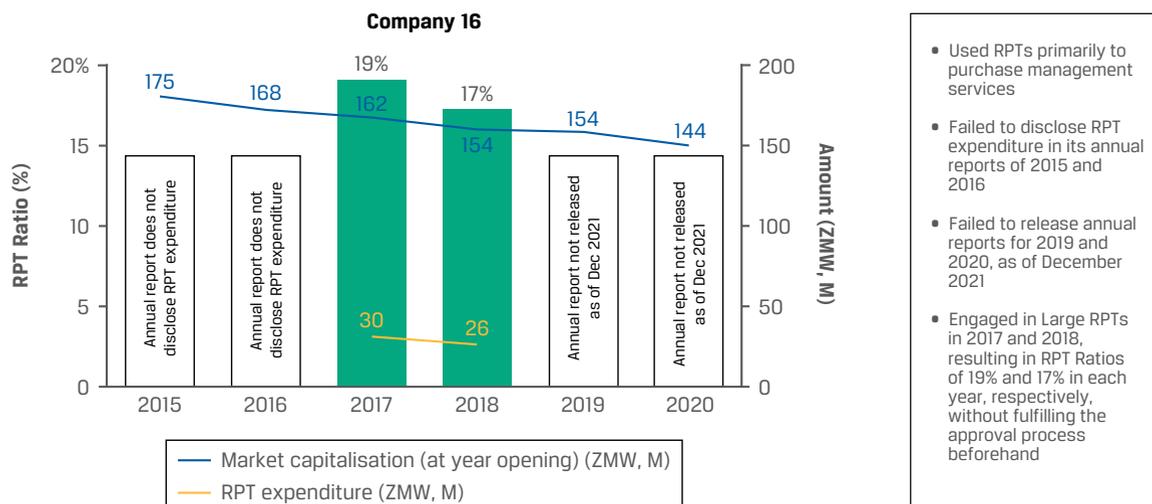


Note: Data for the following companies are based on their latest disclosures: Company 1 (2019), Company 16 (2018), Company 18 (2019).
Sources: Company annual reports (2020); LuSE trade summaries (2019–2020).

The level of non-compliance varies among issuers—by nature, by magnitude, and by duration. Following are cases illustrating the non-compliance (and compliance) of individual issuers with regulations governing RPTs (see Exhibits 6–9).

3.1. Issuer failed to make timely disclosure about RPTs over several years and repeatedly engaged in Large RPTs without fulfilling the approval process beforehand

EXHIBIT 6. RPT RATIOS OF COMPANY 16 (2015–20)



Source: Company annual reports (2014–20).

3.2. Issuers consistently engaged in Large RPTs without fulfilling the approval process beforehand

EXHIBIT 7. RPT RATIOS OF COMPANY 7 (2015–20)



Source: Company annual reports (2014–20).

EXHIBIT 8. RPT RATIOS OF COMPANY 2 (2015–20)



Source: Company annual reports (2014–20).

3.3. Issuer consistently limited RPT expenditure and complied with regulations governing RPTs

EXHIBIT 9. RPT RATIOS OF COMPANY 5 (2015–20)



Source: Company annual reports (2014–20).

4. Non-Compliant RPTs Potentially Inflict Major and Widespread Harm on Stakeholders across the Zambian Economy

With total expenditure on non-compliant RPTs in 2020 of ZMW 3.8B, such transactions improperly divert away an estimated ZMW 0.6 billion to ZMW 1.9B from the Zambian economy each year (see **Exhibit 10**). For each ZMW 100 of inefficient RPT expenditure, approximately ZMW 68 is improperly diverted away from the Zambian economy. Based on three scenarios that each assume different levels of inefficient RPT expenditure, the following amounts are estimated to be improperly diverted away from the Zambian economy each year:

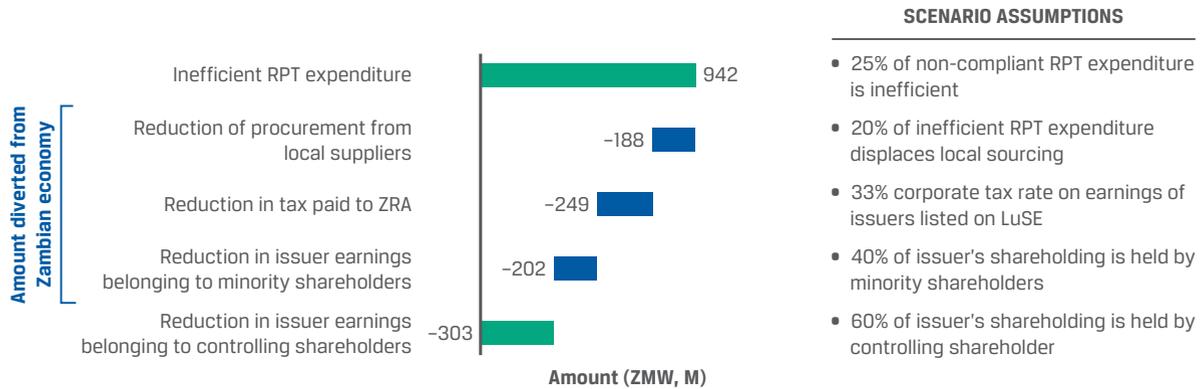
- ZMW 0.6B under a “low” scenario that assumes 25% of non-compliant RPT expenditure is inefficient;
- ZMW 1.3B under a “mid” scenario that assumes 50% of non-compliant RPT expenditure is inefficient; and
- ZMW 1.9B under a “high” scenario that assumes 75% of non-compliant RPT expenditure is inefficient.

The harm from non-compliant RPTs is widespread across stakeholders in the Zambian economy. This harm is experienced by (1) local suppliers, who are displaced in procurement processes that favour issuers’ related parties, (2) the Zambia Revenue Authority (“**ZRA**”), which is deprived of taxable income, (3) minority shareholders, who are deprived of their share of earnings, and (4) custodians of the stock market, whose trading commissions are stifled by suppressed share prices and trading volumes.

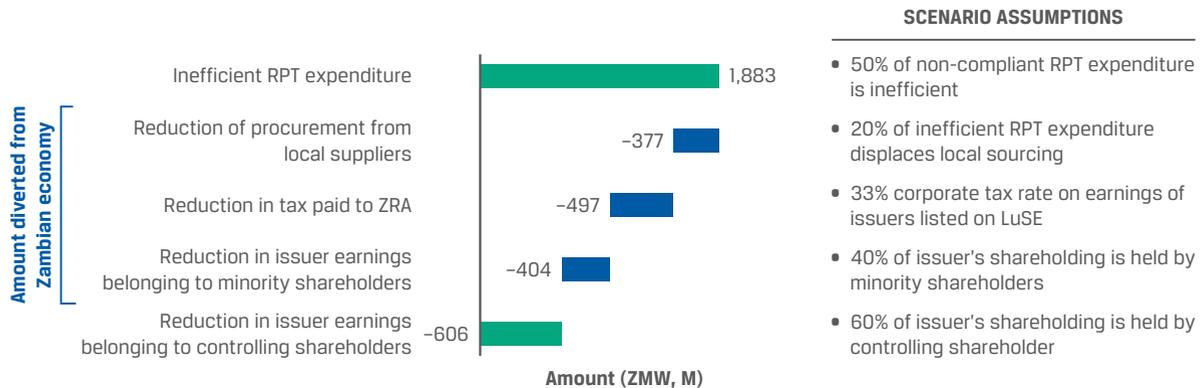
The precise value of inefficient RPT expenditure, and ultimately the amount diverted away from the Zambian economy, can be ascertained only after subjecting each RPT of each issuer to the approval process prescribed in the LuSE Regulations, including (1) interrogation and approval by the majority of shareholders other than the related party and its associates, (2) certification of fairness from the board of directors, and (3) review by the LuSE.

EXHIBIT 10. HARM TO ZAMBIAN ECONOMY FROM NON-COMPLIANT RPTs

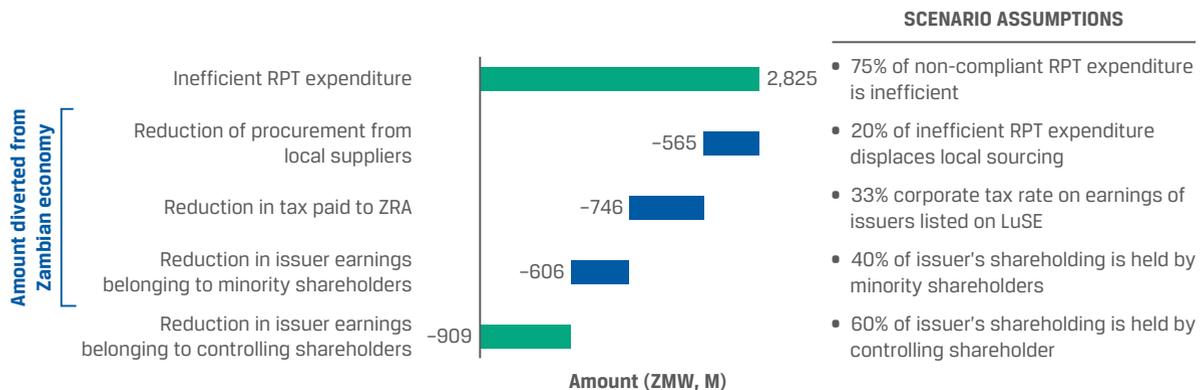
A. Low Scenario: Inefficient RPT Expenditure Diverts ZMW 0.6B per Annum Away from the Zambian Economy



B. Mid Scenario: Inefficient RPT Expenditure Diverts ZMW 1.3B per Annum Away from the Zambian Economy



C. High Scenario: Inefficient RPT Expenditure Diverts ZMW 1.9B per Annum Away from the Zambian Economy



Sources: Company annual reports (2020); LuSE trade summaries (2019-20).

5. Addressing the Harm of Non-Compliant RPTs Requires Corrective Actions

A number of stakeholders that participate in Zambian capital markets can correct the harm of non-compliant RPTs by seeking redress for such RPTs in the past and deterring such RPTs in the future (see Exhibit 11).

EXHIBIT 11. CORRECTIVE ACTIONS FOR NON-COMPLIANT RPTs

	Role in Capital Markets	Action Required	
		Redress for Non-Compliant RPTs in the Past	Deterrence of Non-Compliant RPTs in Future
SEC & LuSE	Regulators of capital markets	<ul style="list-style-type: none"> • Seek damages from non-compliant issuers on behalf of harmed shareholders • Sanction managers and directors of non-compliant issuers in extreme cases 	<ul style="list-style-type: none"> • Educate issuers' managers and directors on regulations governing RPTs • Monitor disclosure of RPTs in issuers' annual reports • Monitor issuers' RPT Ratios routinely • Enforce compliance of issuers with regulations governing the disclosure and approval process for RPTs
Issuers' Managers & Directors	Fiduciary of shareholders	<ul style="list-style-type: none"> • Create a plan to compensate harmed shareholders 	<ul style="list-style-type: none"> • Develop an understanding of regulations governing RPTs • Drive compliance of issuers with regulations governing the disclosure and approval process for RPTs
Minority Shareholders	Owners of invested capital	<ul style="list-style-type: none"> • Seek damages from non-compliant issuers 	<ul style="list-style-type: none"> • Monitor disclosure of RPTs in issuers' annual reports • Monitor issuers' RPT Ratios routinely • Advocate for improved compliance with regulations governing RPTs
Proxy Advisors	Advisors to shareholders		<ul style="list-style-type: none"> • Research equities in Zambian and other African capital markets • Advise institutional investors on issues affecting equity performance, including RPTs
ZRA	Administrator of corporate tax	<ul style="list-style-type: none"> • Seek damages from controlling shareholders for lost corporate taxes 	<ul style="list-style-type: none"> • Monitor issuers' RPTs routinely for possible transfer pricing

Conclusion

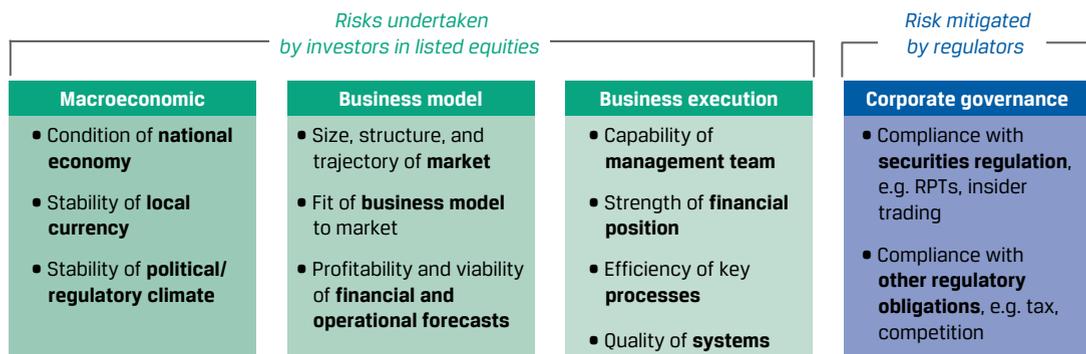
Ultimately, the LuSE's progression toward maturity hinges on improving corporate governance, of which RPTs are a major component.

Corporate governance is an essential system within a stock exchange. A stock exchange is a market that serves, on the one hand, controlling shareholders looking to sell equity in a company and, on the other hand, minority shareholders looking to invest capital in companies. A prerequisite for a mature stock exchange is holding a balance between the interests of these two sets of stakeholders. Corporate governance is the system through which a stock exchange holds this balance in a manner that is equitable and predictable.

Stock exchanges that do not rigorously uphold a system of corporate governance fail to mature. Stock exchanges grow and mature by attracting minority shareholders to buy, and later trade, equity investments. Minority shareholders, like most investors, seek investments where the reward is commensurate with the risk. Therefore, minority shareholders struggle to find suitable investments on stock exchanges where corporate governance risk looms large, is unpredictable in magnitude and probability of occurrence, and renders most rewards untenable.

For this reason, mature stock exchanges across the world operate on the premise that regulators mitigate corporate governance risk while investors continue to carry other investment risks—namely, (1) macroeconomic risk, (2) business model risk, and (3) business execution risk (see **Exhibit 12**).

EXHIBIT 12. INVESTMENT RISKS



The LuSE's responses to corporate governance lapses will shape the exchange's progression toward maturity. To approach maturity, the LuSE need not completely eliminate corporate governance lapses. Instead, a more realistic target for the LuSE is to reduce the harm from corporate governance lapses when they occur by taking prompt and potent corrective action.

This article aims to support the LuSE in its progression toward becoming a mature stock exchange, one on which issuers (1) transparently disclose RPTs, (2) fairly allocate investment returns among shareholders, and (3) positively contribute to the national economy. The authors of this article welcome further discussion on the topics covered. Interested parties may contact Sumeet Jain at sumeet.jain@outlook.com and Godfrey Mwanza at godfrey.mwanza@abam.co.za.

NOTES ON METHODOLOGY

- This article anonymises names of issuers for the most part. The article does not seek to call attention to individual issuers. Rather, it seeks to curb the prevalence of non-compliant RPTs on the LuSE at a systemic level.
- The calculation of RPT Ratios in this article is based on a narrow definition of consideration, which includes only an issuer's expenditure on RPTs, but not the issuer's income from RPTs. Including income from RPTs in the calculation of the RPT Ratio, as is required by Sections 10.8 and 9.6 of the LuSE Regulations, would increase the RPT Ratios quoted in this article.
- The calculation of RPT Ratios in this article is based exclusively on RPTs disclosed by issuers in their annual reports. It is possible that some issuers did not fully disclose RPTs in their annual reports. The existence of such undisclosed RPTs would increase the RPT Ratios quoted in this article.
- The calculation of RPT Ratios in this article excludes dividends paid by an issuer to related parties and their associates.
- This article applies the term "non-compliant RPTs" conservatively to situations in which issuers participate in Large RPTs, but not Small RPTs, without fulfilling the approval process. The amount of non-compliant RPT expenditure would increase if the article counted situations in which issuers participate in Small RPTs without fulfilling the approval process.
- The calculation of RPT Ratios in this article includes only an issuer's RPTs with its controlling shareholder and the controlling shareholder's associates.
- The analysis in this article refers to the latest annual financial results for all issuers as of December 2021. For most issuers, the article refers to financial results from 2020; for two issuers, the article refers to financial results from 2019; and for one issuer the article refers to financial results from 2018.
- The analysis in this article excludes issuers that (1) are dual-listed on other stock exchanges (two issuers), (2) have placed shares on the LuSE's quoted tier as opposed to listed tier (one issuer), and (3) have listed depositary receipts on the LuSE (one issuer). These issuers may be subject to varied regulations and exemptions.
- The findings and proposals in this article are supported by three sets of sources listed in the Bibliography: (1) legal statutes, regulations, and standards, (2) factual evidence from disclosures by issuers and announcements from the LuSE, and (3) secondary studies about corporate governance and RPTs.

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