THE TREATMENT OF CHALLENGES IN LISTED COMPANIES BY THE CMA CODE OF CORPORATE GOVERNANCE PRACTICES, 2015

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DECLARATION

ANN WAMUYU MUREITHI do hereby declare that this thesis is my original work and has not been submitted and is not currently being submitted for a degree in any other University.

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G62/75206/2014

This thesis has been submitted for examination with my approval as the University of Nairobi Supervisor.

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DEDICATION

To the lover of my heart, Raphael and my sons Brian and Edwin, my source of inspiration
ACKNOWLEDGEMENT

This thesis has been made possible by a number of people to whom I am indebted and would like to acknowledge their contributions.

My household supported me a great deal throughout the entire period of this study. Your perseverance and endurance for the long nights I had is highly appreciated. This research received great contribution from the appointed supervisor Dr. Njaramba Gichuki who was always present to offer the necessary direction. Further appreciation is extended to my colleagues and friends who worked closely with me to see this paper successful. I extend my sincere thanks.
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<td>AGM</td>
<td>Annual General Meeting</td>
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<td>APEC</td>
<td>Asia Pacific Economic Co-operation</td>
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<td>APRM</td>
<td>Africa Peer Review Mechanism</td>
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<td>CACG</td>
<td>Commonwealth Association for Corporate Governance</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>CFO</td>
<td>Chief Financial Officer</td>
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<td>CMA</td>
<td>Capital Markets Authority</td>
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<tr>
<td>BCCI</td>
<td>Bank of Credit and Commerce International</td>
</tr>
<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
</tr>
<tr>
<td>ICDC</td>
<td>Industrial &amp; Commercial Development Corporation</td>
</tr>
<tr>
<td>ICPAK</td>
<td>Institute of Certified Public Accountants of Kenya</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
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<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<td>KNTC</td>
<td>Kenya National Trading Corporation</td>
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<td>KWAL</td>
<td>Kenya Wine Agencies Limited</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>Public Company Accounting Oversight Board</td>
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ABSTRACT

This study analyses the Code of Corporate Governance for Issuers of Securities to the Public, 2015 in order to find out whether it addresses the emerging corporate governance challenges in listed companies. The study traces the evolution of corporate governance generally, its historical developments in Kenya and examines the effectiveness of the legal framework on corporate governance in addressing the corporate governance challenges in listed companies.

The general observation from this study is that the changes made in the last few years including the repeal of the old Companies Act, cap 486 and the coming into effect of the Companies Act, 2015 as well as the enactment of the Code of Corporate Governance for Issuers of Securities to the Public, 2015 have improved the corporate governance practices in listed companies. However, much more is required to be done to ensure adequate protection of investors, including strengthening the enforcement mechanism, shareholder awareness programmes to sensitize shareholders about their rights and obligations as investors, ensuring board gender diversity among others.
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CHAPTER ONE

INTRODUCTION

Different academicians have defined corporate governance in various forms.¹ One way is where the definition of corporate governance has a contracted interpretation to reflect the relationship that exist between shareholders and the company that they have invested in.² The other way is defining corporate governance as a network of many relationships normally found within an organizational setting like the case of company and its employees, persons owed money, customers and suppliers.³ Various authors have put forward varying definitions depending on whether the relationship is taken as one between the company and its shareholders or whether it is taken as a network of relationships of many stakeholders. Shleifer and Vishny⁴ define corporate governance to mean a system that guarantees that investments made into a business by investors will yield a return. This definition is a contracted interpretation to the relationship existing between shareholders and the Company they have invested in.

Jill Solomon and Aris Solomon⁵ defines corporate governance in terms of being a system to oversee the management and direction of the company which guarantees that companies are accountable to all their stakeholders. This definition assumes that by being accountable to all their stakeholders, companies can increase value creation.⁶

Corporate governance is interested in providing the strategic direction of companies and monitoring the actions of management. It is not interested in the daily operations of the business as such.

Corporate governance is essential in promoting the prosperity of corporates and also for social welfare⁷ At an international level, there are many instances of large corporate collapses that have

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¹ Jill Solomon and Aris Solomon, Corporate Governance and Accountability (John Willey & Sons Ltd, 2011) 12
² Ibid p. 12
³ Supra note 1 p. 12
⁶ Supra note 4 p. 14.
arisen from corporate governance structures that are not strong which have necessitated the improvements. Examples of these corporate collapses include the fall of Enron, WorldCom and Tyco in the United States of America (USA) as well as Maxwell and Bernie Madoff scandals in the United Kingdom.

Enron was a large energy company in the USA, which was founded in 1985. The Company had a phenomenal growth. By the time of its collapse, the company had grown from offering one product (energy) alone to two products (financial and energy trading company). In December 2001, it filed for bankruptcy. In subsequent months, confirmations of weaknesses in corporate governance as well as of fraudulent activities that were being perpetrated by the business came to the fore. These included misstatements in financial report on facts that had a bearing on the decision making process through misrepresenting the earnings report. Internal audit committee members had conflict of interest while Chief Executive had immense powers. Enron Board was weak and did not detect fraudulent accounting practices and unethical behaviour. The board was made up of people who were morally poor and were willing to conduct fraudulent activity. Enron’s top management was accused of insider trading, for selling Enron’s shares to other investors.

WorldCom was a large telecommunications company in the US in which many retirees had invested in. It attempted to improperly overstate its earnings numbers by about $4 billion by misrepresenting its financial statements, through spreading operating expenses in property accounts thereby showing expenses in small amounts over a number of year. The former CEO of WorldCom, Bernie Ebbers, was convicted in 2005 of the offence of organising the accounting fraud and was imprisoned for a term of 25 years. WorldCom directors were appointed to the Board due to various reasons. Some of them were appointed due to their good experience in business and

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8 Ibid p. 286  
9 Supra note 1 p. 32  
10 This was Chapter 11 bankruptcy which is a type of court protection giving company management time to make arrangements with the creditors.  
11 Supra note 1 p. 35  
12 Supra note 1 p. 41  
13 Supra note 1 p. 41  
legal issues. However, some directors were chosen as they had a close relationship with Mr. Ebbers. In view of this, the Directors were not well versed with the issues in WorldCom’s issues.

Tyco was a securities system company that grew through numerous acquisitions. Tyco scandal involved the CEO, Mr. Kozlowski and Mr. Mark H. Swartz, the CFO who stole $150m by siphoning money by accessing loan facilities that had not been approved together with posting stock sales which were not genuine. The money was siphoned out disguised as either bonuses or benefits for executive directors. The scandal was discovered by SEC through an investigation that discovered accounting practices that were not in line with International Standards together with loans in large sums extended to the CEO that had been forgiven. Mr. Kozlowski and Mark H. Swartz were convicted and imprisoned for a term of up to 25 years for the offences of receiving unauthorized bonuses, and misstating the company's books.

The US Government reacted strongly to these collapses by enacting the Sarbanes Oxley Act in 2002. It also gave PCAOB powers to inspect, enforce and set standards for the audit profession. It further made executives accountable thereby boosting transparency. It also prohibited public companies from lending to directors and the executives.

In the United Kingdom, a several corporate scandals were reported in the period running into the late 1980s. The public was angered by the theft by Robert Maxwell of monies contributed for

16 Ibid p. 30-31
18 Ibid
20 Sarbanes Oxley Act of 2002. Section 1014 of the Act established the Public Company Accounting Oversight Board (PCAOB) to oversee the auditing industry.
21 Section 302 of the Act required listed companies to come up with an audit committee that is separate from management and which should be responsible for appointing, deciding on the compensation together with overseeing the external auditor
22 The Act provided that the CEO and CFO should certify financial reports; and also that the efficacy of internal controls over financial reporting should be evaluated and that the auditor to attest to management’s representation.
23 Supra note 21 S. 402
retirement and the failure by external auditors to uncover the fraud at the Bank of Credit and Commerce International (BCCI) which was going down.

This scandal associated with Maxwell is regarded as “the greatest fraud of the 20th Century”. Mr. Robert Maxwell was discovered to have withdrawn money from a fund saved for retirement by scheme members employed in public companies. The purpose of the funds was personal activities not related to the organization. The total amount embezzled was estimated to be £727 Million the companies’ assets. The major problem discovered to be too much powers which had not been separated as Maxwell served as both the CEO and Chairman between 1981 to 1991 of the Macmillan Publishers. Other causes for the failure to discover misappropriation in good time included powers given to Maxwell to appoint directors who had no executive powers to the board. These directors failed to operate independent hence were compromised in their function.

Although the directors with no executive powers were reputable, they failed to give proper and accurate financial position of the company to shareholders in good time. They lacked transparency and ethics in the manner that Maxwell reported the financial activities.

BCCI was a multinational bank operating in several jurisdictions. In July 1991, regulators of banks drawn from seven countries raided the assets and locked them. This was after regulators in Great Britain discovered that the bank was engaged in money laundering and fraud.

The UK Government in its response commissioned a special committee to review and give a way forward on matters related to finances with regard to corporate governance. The Committee published the Cadbury Report in 1992. The Committee was of the view that the quality of board oversight could be enhanced by having an independent board. The London Stock Exchange

26 Supra note 1, p. 46
27 Supra note 1, p. 47
29 The Committee was chaired by Sir Adrian Cadbury, CEO of Cadbury Confectionery Empire, and included other senior industry executives, finance specialists and academics
30 The Code recommended that public companies should have boards comprising at least three non-executive directors. Paragraph 4.9 of the Code recommended that positions of CEO and Chairman should be separate and be occupied by two separate persons.
adopted the proposals by the Cadbury Committee. Key principles touching on the integrity, openness and accountability were incorporated in the Cadbury Code of Best Practice. The Code was recognized internationally and was used as a classic example in promotion of various governance codes around the world.

Recognizing that economic growth and financial markets can be enhanced through the implementation of good governance practices, the OECD issued corporate governance principles in 1999. The policymakers and investors across the world use the OECD corporate governance principles as a yardstick to measure the governance practices in a particular country. The principles have also been used as guidelines for legislative as well as regulatory corporate governance frameworks in OECD member and other countries.

Good corporate governance practices should be fostered especially in emerging countries with the aim of enhancing economic growth so that the standards of living of the people can be enhanced. Securities markets are a fundamental aspect of the economic development and corporate governance plays a key role.

1.1 Statement of the Problem

Research shows that the implementation of good corporate governance practices generally improves the productivity of an organization or a company; thus contributing immensely to growth of the economy. Operating within the confines of corporate governance practices bolsters investors’ confidence in the economy leading to economic growth and efficiency. To this end, it is clearly shows that corporate governance is a necessary initiative that ought to be embraced by all issuers of security for the sake of stability of the economy.

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31 The London Stock Exchange introduced a new set of rules related to the Listing requirements for companies to provide clear information in their financial reports as to whether or not they were compliant with the Cadbury Report provisions and the Code spelling out the best practice.
33 OECD is an international body established to promote sustainable growth and financial stability of members.
34 OECD, *OECD Principles of Corporate Governance* (2004). These Principles have been reviewed on several occasions with the latest review done in 2015 and known as G20/OECD Principles on Corporate Governance.
Much as there are positive strides made to improve corporate governance in Kenya, with improvements in the legal regime on corporate governance, the menace of incessant failures of corporate governance has not been cured. This is because there are glaring gaps in the legal framework and lack of precise provisions that enhance oversight mechanisms in a bid to check the management of corporations. In addition, the enforcement mechanisms are also lacking. With these flaws, there is impending danger that the country will witness more corporate governance failures even after amending legislation and guidelines altogether.

The Code of Corporate Governance practices for Issuers of Securities to the Public, 2015 (the Code); which is meant to sum up all corporate governance guidelines for issuers of securities exhibits *prima facie* flaws *inter alia*, gaps in the enforcement structure and coordination; fluid provisions on diversity and gender balance and carte blanche provisions on the size and structure of the board.

In view of the highlighted shortfalls in the corporate governance legal regime in Kenya, it is imperative to analyse whether the Code and the entire legal regime adequately addresses the current corporate governance challenges in listed companies. This study will therefore examine the Code and the whole regime of corporate governance in Kenya in a bid to find out to how it addresses the weaknesses identified in the current legislation; and whether the Code sufficiently addresses the emerging corporate governance challenges in listed companies.

1.2 Objectives

The main objective of the study is to demonstrate the extent to which the Code of and the entire legal regime on corporate governance address the emerging corporate governance challenges in listed companies.

This research further intends to fulfill the following specific objectives;

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38 The improvements in the legal regime include promulgation of the Companies Act, 2015 to replace the outdated Companies Act, Cap 486; the provisions of the Capital Markets Act, Cap 485A; and the enactment of the Code of Corporate Governance for Issuers of Securities, 2015 which repealed and significantly enhanced the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002.
(a) To review the background of corporate governance, regional and global and the developments made to improve the governance practices in Kenya;

(b) To consider the legal/regulatory framework put in place to ensure best governance practices in Kenya;

(c) To demonstrate the main corporate governance challenges facing listed companies in Kenya, analyse the efficacy of the legal and institutional/ regulatory framework for corporate governance for listed companies in Kenya in relation to the grand objective of ensuring adequate investor protection;

(d) To come up with conclusions and recommendations on appropriate measures that will enhance good governance practices in the country.

1.3 Research Questions
This study seeks to answer the following questions;

a) What is the current legal/regulatory framework of corporate governance in Kenya?

b) What are the main governance challenges facing listed companies in Kenya?

c) Is the current regulatory framework for corporate governance for listed companies in Kenya sufficient to assure adequate investor protection?

d) What should be done to enhance corporate governance practices in listed companies in Kenya?

1.4 Hypothesis

i. The current corporate governance legal regime is inadequate to address emerging challenges.

ii. The changes made in the last few years in the country’s legal framework on corporate governance have improved protection of investors but much more is required to be done to ensure adequate protection of investors.
1.5 Theoretical Framework

This study is grounded on the Agency Theory of corporate governance, which postulates that since it is not possible to foresee and mitigate all the actions of an agent which affect his own well-being and that of his principal, agency problems occur. Many researches have been done on the agency problem, starting with Ross. Jansen and Meckling presented an exhaustive study of agency theory. The shareholder assigns the responsibility of managing the daily operations and making decisions relating to the business to management who are his “agents”. The problem arises because the agents may make decisions that are for their own benefit but are not for the benefit of the principal. The theory presupposes that the agent and the principal have conflicting interests.

It is assumed that the main reason why companies are set up is to make the most wealth for the shareholders. However, in reality, this may not be the case as those charged with managing the company may choose to carry out objectives that are beneficial to themselves and not to shareholders. They may concentrate on investments that yield high returns in the short term especially in cases where their pay is pegged on profitability of the company rather than pursuing objectives that will result in shareholder wealth maximization which as longer term in nature.

The theory assumes that the principal cannot easily authenticate the actions of the agent. However, shareholders have powers that they can use to monitor management, including:

a) Using their voting rights that are exercised during the Annual General Meetings;

b) Voting in favour of acquisition of the company by other investors especially if not contented with the direction the company.

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42 In the study, the managers of the company were defined as the “agents” and the shareholder as the “principal.”
43 Ibid p. 307
44 Supra note 1 p. 17
45 Supra note 1 p. 17
46 Supra note 1 p. 17
c) Passing of shareholder resolutions, especially where shareholders join hands and collectively demand management to act on areas that are of concern to them;

d) Divesting from the company if the shareholder is not satisfied with how the business is being managed.

The legal/regulatory regime of corporate governance in Kenya acknowledges the importance of Agency Theory.\textsuperscript{47} The shareholders’ rights are a means of monitoring the management of companies where the shareholders have invested in.

This research is also premised on the Shareholder Primacy Theory. This theory holds that interests of shareholders need to be assigned foremost priority in relation to other stakeholders in an organization.\textsuperscript{48}

Various scholars have contended that the growth of shareholder primacy has a negative influence on corporate employees’ welfare.\textsuperscript{49} It is argued that there are different types on capitalism\textsuperscript{50} and in most of them, the shareholders’ welfare is taken to be the most important, above those of the employees.\textsuperscript{51} The shareholder primacy theory states that the purpose of a company is to make the

\textsuperscript{47} This is in view of the fact that the Companies Act, 2015 as well as the Code of Corporate Governance Practices, 2015 provide for recognition and implementation by the boards of companies of shareholders’ rights.

\textsuperscript{48} The theory states that “all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears” see Adolf Berle, ‘Corporate Powers As Powers In Trust’ Harvard Law Review (1931) Vol 44 Pg. 1049


\textsuperscript{50} The Varieties of Capitalism literature suggests that there are different types or families of capitalism; see for example, P. Hall and A. Soskice, Varieties of Capitalism: The Institutional Foundations of Comparative Advantage, Oxford University Press, Oxford, 2001; H. Gospel and A. Pendleton, Corporate Governance and Labour Management, Oxford University Press, Oxford, 2005.

\textsuperscript{51} This argument posits that directors will consider the interests of shareholders at the expense of the employees’ interests
most wealth for its shareholders. Various nations like the UK, USA, Canada, and Australia clearly demonstrate the shareholder primacy in their corporate governance.

This school of thought argues that as companies attempt to increase value by re-organising the business, the highest impact is felt by the employees who sometimes are laid off and the working conditions deteriorate. However, it is worth noting that during the restructuring, workers who are not laid off experience more work load, reduced pay and unfavourable working conditions. The concerns of the workers in the re-organisation are not considered at all. Directors are responsible for re-organising the company in order to increase profits and enhance growth with the objective of making the most wealth for the shareholders. The Dodge v. Ford Motor Co represent the most often quoted expression of shareholder primacy.

The theory means that when making decisions, persons holding the positions of directorship together with the individuals charged with the responsibility of management should only take into account the welfare of shareholders, and so long as a decision will result to increase of shareholder’s wealth, the effects of that decision to other stakeholders do not matter.

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55 Supra note 51.


57 170 N.W. 668

58 “A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.
It is arguable that the repealed 2002 corporate governance guidelines were inclined more to the shareholder primacy theory. This is because most of the requirements in 2002 Guidelines were geared towards protecting the shareholder than any other stakeholder.

The study is also based on Stakeholder Theory. The theory states that in view of the fact that companies influence greatly the societies where they carry out the business, the company should consider the welfare of these societies and not just the welfare of the shareholders when making decisions.  

The stakeholder theory postulates that in managing organisations, the welfare of others in the society should be considered in addition to considering the welfare of shareholders. This is because shareholders are just one of the stakeholders that contribute to a corporation and are impacted by the actions of a corporation.

Edward Freeman, a proponent of the Stakeholder Theory defined a stakeholder. They comprise among others, workers, consumers, government, lenders and others where the corporation operates. The welfare of these stakeholders should be considered when making decisions in a corporation.

The Code which repealed and replaced the 2002 corporate governance guidelines is inclined more to the Stakeholder Theory. The Code has chapters on stakeholder relations and on ethics and social responsibilities.

1.6 Scope of the Study

This study focuses exclusively on the corporate governance practices of listed companies in Kenya. This is because a study of listed and non-listed companies would be too wide for the time available to carry out this study.

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59 Supra note 1 p. 23
62 A stakeholder is “any group or individual who can affect or is affected by, the achievement of a corporation’s purpose.”
63 The Code defines a stakeholder as anyone who is impacted by the decision of a company and includes shareholders, customers, suppliers, among others"
1.7 Literature Review

Lois M. Musikali\textsuperscript{64} focuses on the legal provisions on corporate governance in Kenya, and identifies the gaps in the law before advocating for a need to review the laws on director liability, among others, to reflect a dual standard of liability with both subjective and objective elements of liability.

This was authored in 2008 prior to coming into effect of the Companies Act, 2015. The position has now changed, especially with the codification of directors’ duties in the Act. This paper seeks to find out whether the changes made in Kenya a couple of years ago have addressed the concerns raised by the author.

Waweru and Kamau\textsuperscript{65} investigates the implementation of the recommendation for the constituting of committees in charge of audit as a significant step towards improvement in corporate governance among firms whose share trade publicly in a stock exchange. The study was conducted on 29 companies listed in Kenya’s security Exchange and 93% of those companies had implemented the recommendation. They noted that these committees charged with audit processes resulted in enhanced level of independence in the functions of internal audit as they ensured that recommendations made by the internal audit were taken seriously by management and implemented.\textsuperscript{66}

This article was authored on the basis of the 2002 Guidelines on corporate governance practices for companies that had their shares trade at a stock exchange, which required that all such companies institute an audit committee. The requirement for audit committees was retained in the Code for Corporate Governance Practices, 2015. This paper will analyse whether the implementation of the audit committee requirements has enhanced investor protection in Kenya.

Gakeri\textsuperscript{67} noted the prevailing gaps in the current corporate governance structures among firms whose shares trade at the Stock exchange in Kenya by arguing that they did not protect


\textsuperscript{66} Ibid p. 30

\textsuperscript{67} Jacob K. Gakeri, ‘Enhancing Kenya’s Securities Markets through Corporate Governance: Challenges and Opportunities’ International Journal of Humanities and Social Science, Vol. 3 No. 6 [Special Issue – March 2013] 97
shareholders’ interests. They therefore do not promote investor confidence as is evident from the persistent corporate scandals. He reviews the principles that are in force for public companies, the regulatory requirements and the responsibility of the CMA in ensuring that the Corporate Governance Guidelines are implemented. He argues that the Corporate Governance Guidelines have not improved the corporate governance practices. He notes some of the reasons for the failure to improve corporate governance as the underlying legal framework which is not supportive or facilitative; inability of CMA to ensure the Guidelines are implemented and; listed companies’ refusal to be accountable and to adopt good governance practices.

The article was authored in 2013, prior to the enactment of the Code that repealed the 2002 corporate governance guidelines. This study analyses the Code to find out whether the concerns raised by the author have been addressed. This paper also concurs with the author’s views especially on the need to enhance the enforcement mechanism and the need to explicitly set out the responsibilities of independent and non-executive directors.

Kiarie Mwaura assesses the effectiveness of the measures put in place to increase productivity of parastatals including investigating how they evolved, how they influence the economy, why they have poor performance. He also makes recommendations on improving the effectiveness of parastatals. He argues that it is imperative to rationalize the laws governing parastatals which are too many with a view to making them more efficient. He states that it is important to restructure the corporate regulatory framework, including a review of the outdated Companies Act, Cap 486 to improve governance.

This paper investigates whether the changes made in the last couple of years ago addresses the concerns raised by the author.

According to Mwanzia, developing countries need to come up with corporate governance practices that are appropriate for their cultural, political and technological conditions. He examines

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68 Ibid p. 117
69 Supra note 68 p. 115
the history of corporate governance and the theories that affect corporate governance. He fails to
discuss the importance of good corporate governance legislation and codes that are adequate to
reduce the corporate failures in Kenya, which this paper seeks to address.

Gordon\textsuperscript{72} made a prescription of adoption of independent boards following the Enron scandal in
which he suggests that audit committees ought to be more independent from the management. This
paper seeks to further evaluate whether these requirements for composition of the audit committee
instill confidence in investors as to the independence of oversight of operations of the corporation.

Ruparelia and Njuguna\textsuperscript{73} give a detailed account of the history of evolution of Corporate
Governance in various jurisdictions including Kenya. The two authors discussed the historical
developments in corporate governance especially in the UK, the US and the OECD with Kenya as
the locus. The essence of the study was to highlight the gains that have been made as a result of
the continuous changes or improvements on policy and regulations governing corporate
governance across the world.

Despite highlighting the developments that have been made over the years, the authors fail to go a
step further and interrogate whether the documented evolution of the legal regime has translated
into tangible improvements in corporate governance in Kenya. They also fail to find out whether
there are any shortfalls which are yet to be cured. This paper will look at the evolution of corporate
governance and evaluate whether the improvements made in the last few years are adequate to
ensure protection of investors.

Miring’u and Muoria\textsuperscript{74} embarked on an investigation of the effectiveness of corporate governance
on the financial position of parastatals in Kenya. The empirical analysis majorly considered the
number of directors in a corporations vis-à-vis the return on investment of the same corporation.
The findings of this analysis were that corporate governance constitutes the organizational climate

\textsuperscript{72} Jeffrey N. Gordon and Mark J. Roe, eds., ‘Convergence and Persistence in Corporate Governance’, European
Business Organization Law Review 7(02):605 - 614 : June 2006 Available at
https://www.researchgate.net/publication/231859694_Jeffrey_N_Gordon_and_Mark_J_Roe_edds_Convergence_and
_Persistence_in_Corporate_Governance Accesses, 10\textsuperscript{th} June, 2019.

\textsuperscript{73} Ruparelia Rita. & Amos. Njuguna, ‘The Evolution of Corporate Governance and Consequent Domestication in
Kenya,’ International Journal of Business and Social Science, Vol. 7, No. 5; May 2016, 154

\textsuperscript{74} Miring’u Alice and Esther Muoria, ‘An analysis of the effect of Corporate Governance on Performance of
Commercial State Corporations in Kenya’ International Journal of Business and Public Management (ISSN: 2223-
6244) Vol. 1(1): 36-41
of a corporation and therefore, it cannot be underestimated. Corporations with an expansive board made of more independent non-executive directors was more likely to have high investment returns as opposed to corporations with a lesser board with almost all the directors from within the corporation. The authors concur with previous research that boards of corporations should comprise at least three non-executive directors.

In this study, the authors considered only the aspect of the number of directors. This paper will analyse the various attributes of corporate governance, not just the number of independent directors and make recommendations to enhance investor protection.

Mbai did a study on how parastatals are responsible for their actions in Kenya in which he examined the history and running of parastatals in Kenya since independence. His conclusion was that corporate governance has been poorly effected in Kenya because there were ineffective governance practices and the quality of board directors of state corporations was poor. Mbai highlights some corporate governance flaws to include a weak legal framework, corruption and political interference with the running of these corporations.

In line with this study, this paper will establish if the same weaknesses are rife in the current legal system on corporate governance in respect to all corporations and further chart a way forward for reinforcing best corporate governance practices.

Garratt sought to find out why corporate governance has failed in a study whose conclusion was that the main cause of such failures is because the responsibilities and accountability of the board of directors is not defined in clear terms and understood by politicians, policy makers and business executives as well as the public. He added that boards of directors ought to be professionalized and its supremacy spelled out in clear terms so as to restore confidence in the business and the markets as a whole. This paper seeks to find out whether these concerns have been addressed in the current legal/regulatory regime of corporate governance.

Oloo makes a case for increased regulation of the market in a bid to enhance corporate governance in the capital markets. According to his study, the impact of such regulation would be to set out

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clear rules and procedures on how affairs of the board of directors should be conducted. The study further deduced that there ought to be a foolproof system of accountability in respect to public owned institutions such as State Corporations since it is important to prudently manage investor resources since the shareholders are citizens who fund the state corporations by paying taxes. The findings of this study will be used to confirm whether the concerns raised by the author have been addressed.

According to Andrew Moirore Rori’s thesis on challenges affecting corporate governance in State Corporations, he notes there has been considerable support from both within the country and outside the country for the course of streamlining corporate governance in the public and private sectors. The article identifies the challenges facing state owned corporations and the measures that were put in place in a bid to address the said challenges in terms of formulation of policy. The conclusion from this study is that in order to enhance corporate governance in parastatals, directors should be appointed on the basis their skills and qualities their roles should be defined. Clear guidelines on procurement of goods and services by the corporation and good succession plans for directors; transparency and internal controls. The findings of this study will be used as one of the yardsticks of determining whether the legal framework in place on corporate governance is effective enough.

The foregoing literature leads us to some weaknesses in the framework on corporate governance in place now. The gaps include; absence of a regulatory framework to entrench external audit function as an important element of corporate governance; inadequate criteria on selection of directors, inadequate statutory mechanisms for holding directors accountable, among others.

Some developments have occurred in the recent past, including enactment of Companies Act, 2015 to replace the old Companies Act, Cap 486 Laws of Kenya as well as the enactment of the 2015 Code which replaced the 2002 Guidelines on Corporate Governance. It is therefore, important to review the current legislation to assess whether it responds to weaknesses identified.

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1.8 Research Methodology

The study will largely be conducted through historical or documentary research design. This consists of discovery and examination of information that is already available. This design of investigation has been chosen for the reason that the proposed research will entail scrutinising and evaluating the relevant literature for the framework of corporate governance in Kenya. One way of conducting historical or documentary research is by looking at books or articles published in a certain area and study the trend or the relationship of the articles presented. The study will thus rely on library research, and will analyse the new Code of Corporate Governance.

The source of data proposed to be relied on will be both primary and secondary sources. An analysis of the Code will be conducted as the source of primary data. With regard to secondary sources of data, books, journals, articles and reports, both in the hard and soft copy through the internet on the subject of research will be reviewed and consulted.

1.9 Chapter Breakdown

Chapter one is the introduction to the research. The chapter comprises the statement of the problem, objectives of the research, research question and hypothesis, theoretical framework, research methodology, literature review and the chapter breakdown.

Chapter two chronicles the history of corporate governance globally and in Kenya and the developments made over the years to enhance corporate governance practices in Kenya through enactment of various legal instruments.

Chapter three analyses the Code of Corporate Governance Practices, 2015 in relation to other legal instruments on corporate governance in Kenya after which analysis it generally brings to the fore the inadequacies of the current legal regime in respect to ensuring the best corporate governance practices.

Chapter four looks at the effectiveness of the legal and regulatory framework in addressing corporate governance challenges in Kenya by dissecting through the specific flaws in the corporate

80 Ibid Pg. 168
governance regime which might be at any time exploited by some corporations. This analysis will be made by looking at some corporate governance challenges of a listed company, Uchumi Supermarkets Limited.

**Chapter five** contains the findings and recommendations of the study.
CHAPTER 2

HISTORY OF CORPORATE GOVERNANCE

2.1 Introduction

This Chapter chronicles the historical development of corporate governance globally, regionally and in Kenya and further gives an account of the key committees and recommendations that have made groundbreaking transformations in the corporate governance regime. The chapter will also identify the gains made in relation to adoption of best corporate governance practices in the country in view of the developments.

2.2 Evolution of Corporate Governance Globally

Corporate governance is not a recent phenomenon. The way a corporation’s ownership is structured largely determines the system of corporate governance. Berle and Means laid the groundwork and stated that as the size of corporations increases, they could separate control from direct ownership by having different systems of control and of ownership.

Across the world, the first traces of failures of corporate governance were exhibited in the 1600s when the British East India Company, in a bid to increase the amount of money it desired to remit to the British government; committed a lot of atrocities against the people of India since it had access to military force and weapons. Since it was owned and controlled by the then political class, the management would do anything to ensure that a lot of tributes were delivered to the crown. In respect to the operations of the British East India Company, the King’s Bench was faced with a question of whether a corporation would engage in criminal acts in the Case of

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81 Supra note 73 p. 19
82 Supra note 1 p. 2
84 This was a Crown chartered company which had the rights to do business across the East Indies but majored its business in India alone. Its head office was the East India House in London.
85 The owners of stock in this Company were merchants who had influence and access to the crown and that is why it was easy for the Company to be granted a charter. Much as this was just an association of merchants, members were at liberty to engage in their own businesses.
86 East India Company, Frederick Charles Danvers (1833–1906) and Sir William Foster (1863–1913)
Sutton’s Hospital[^Sutton] where it held that a Company cannot commit a crime and therefore the decision makers who engineer crucial decisions in the Company cannot equally be convicted of certain criminal acts for which the Company cannot be accused of. At this point there was no law or obligation requiring Directors of a Company to be accountable for their misdeeds.^[Koessler]

The next manifestation of corporate governance challenges came in 1720 when there was the South Sea Bubble. The South Sea Company was incorporated in 1711 with a view of reducing the British Government’s national debt. It was thus given the monopoly of trading in South America and other nearby Islands.^[Carswell] The management of the Company overpriced its stock and when many people fell for the misrepresentation and started projecting that the Company would make a lot of profits since it was enjoying monopoly status, it collapsed since its intrinsic value was determined to have been lower than the value of the stock for the reason that there was not much trade between the Company and South American countries which were still under the control of Spain.^[Ibid] This collapse steered the enactment of the Bubble Act which restricted creation of joint-stock companies without obtaining a royal charter.

The mid-seventeenth saw progression in corporate governance since many companies had started raising share capital, enjoyed the limited liability status, would distribute profits to members and share dividends, members would transfer their shares and there developed good internal management structures which facilitated director and shareholder meetings. At this point, shareholders were given an opportunity to nominate or employ whomever they wished to be a director of the Company. All these developments were set in motion partly because the charters had recognized the importance of such practices and also because it had become a custom in various trades. In light of these developments the role of directors started being shaped progressively.^[Davies]

[^Sutton]: (1612) 77 ER 960, 973
[^Carswell]: Carswell, John, The South Sea Bubble (London, 1960) 37
[^Ibid]: Ibid
[^Davies]: Paul L Davies, Gower’s Principles of Modern Company Law (6th ed, 1997) 21
In the late 18th Century, many companies sought to expand their capital by seeking out investors to buy shares in their companies. At this point, the investors were not involved in management and running of the companies in which they had invested. Adam Smith pointed out in 1776 that this was not a viable model since owners of capital ought to have been involved in management of their resources. He posited that a director was not expected to watch over the resources as vigilantly as the real owners would have done. His worst fear was that negligence and profusion would be prevalent.

The UK legislated the Joint Stock Companies Act, 1844. The Act provided various ways in which a company could be incorporated. Prior to enactment of the Statute, incorporation of companies was by a Royal Charter or a Private Act and enjoyed the protection and privileges as granted by parliament. Owing to this restricted mode of incorporation, many businesses were unincorporated and would thus not enjoy the status of a separate legal entity. If anyone wanted to sue the business, they would have to sue all the members in their personal capacities. With the inception of the Joint Stock Companies Act though; control of the corporations was effectively separated from the ownership.

In 1855, there was enacted, still in the United Kingdom, the Limited Liability Act whose main objective was to shield the owners of a company from liability over and above the investment they have made in the company. This move was majorly aimed at protecting firms and shareholders from liability arising from negligence and mismanagement by professional managers (the current directors).

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93 Ibid.
94 Joint Stock Companies Act 1844 (7 & 8 Vict. c.110)
96 Limited Liability Act 1855 (18 & 19 Vict c 133
In the 19th century, just after the industrial revolution in Britain, a number of commercial entities started to develop model villages close to their factories with a view of affording their workers free housing, free health care and free education. This was the first indication of corporate social responsibility in the business world since it had been established that a corporation would always make great financial gains if the workers were exposed to a friendly working environment and the general public were also supportive to the corporation’s operations.98

In the 1980s, corporate governance gained prominence following the stock market crashes around the world and owing to the failure of existing frameworks to prevent corporate collapses.99 As more corporate entities collapsed in 1980s, the attitude changed and boards of companies were expected to make sure that companies were successfully run and with good practices.100

In 1990s, various structures of corporate governance were implemented throughout the world. In jurisdictions with civil law legal systems like Germany and Netherlands the corporate framework that was developed placed inordinate emphasis on stakeholders. In these jurisdictions, the function of the corporate framework was to take into account the concerns and interests of various stakeholders, including workers, clients etc.101 Conversely, jurisdictions which embraced common law legal system e.g. UK and Canada, among others, implemented structures that were centered on the returns to shareholders. The role of the governance framework was to guarantee the achievement of the shareholders’ interests.

Most of the Committees that attempted to address corporate governance issues originated in UK102 following several corporate collapses in the 1980s and 1990s.103 The collapses could be attributed to common reasons which were cited as; failure to inform investors about the progress of the Companies; publication of misleading financial statements; complacency by external auditors;

100 Supra Note 65 p. 15
101 Ibid
102 Supra note 67 p. 156
management functions being carried out by powerful, yet clueless shareholders who could not be restrained by colleagues, and finally ineffective risk management systems.

In a bid to address these shortfalls, a number of Committees were subsequently tasked with interrogating the ways in which the corporate structures of would be made more robust. In May 1991, the Committee on the Financial Aspects of Corporate Governance was set up, chaired by Sir Adrian Cadbury where the name, ‘the Cadbury Report’ came from. The Committee was formed to address the challenges faced especially on adequacy of financial reporting and responsibility of companies, especially following the BCCI and Maxwell scandals.

In 1994, the Greenbury Committee was established to address concerns raised by the shareholders and the public at large on the high pay made to senior management. The Committee recommended that remuneration committees be constituted in the board comprising of independent directors to fix the pay for executive and independent directors. The Report further recommended that pay be directly connected with performance, should not be too much but should be such that it can attract people with the right skills and qualities to the business.

Alarmed by the status of corporate governance across the world and the numerous corporate crushes; in 1997, the Commonwealth heads of State crafted the International corporate governance network in a bid to stimulate the growth of corporate governance. This network gave birth the Commonwealth Association for Corporate Governance (CACG) which has overseen a number of developments since it came into place. The CACG has succeeded in its campaign to implement of good governance practices within the Commonwealth, going beyond the salient differences in


105 The Bank of Credit and Commerce International

106 The Cadbury Report which was published in 1992 established good corporate governance principles that were subsequently incorporated as part of the London Stock Exchange’s Listing Rules. The Committee recommended, among others; that independent and non-executive directors should be increased; that the CEO and Board Chairman positions should be separate and be held by different persons, and that subcommittees of the board composed of non-executive directors be established to monitor and supervise the activities of the management.


culture, wealth and size of the commonwealth countries. The association has also initiated corporate governance programmes for capacity building in over 30 countries. It has also laid down the Commonwealth Principles for Corporate Governance, as well as the Best Practice Guidelines for Boards of Directors. A lot of the provisions contained in the first Kenya Code of Corporate Governance and Guidelines for Directors originate from the work of the Association.

The Hampel Committee was constituted in 1998 to evaluate whether the original purpose of the Cadbury and Greenbury Reports had been achieved. The Turnbull Committee was formed in 1999 to guide companies on implementation of the requirements of the Combined Code, especially on internal control. The Report assisted the boards to meet the requirements that the system of internal control should be thorough and reliable; and that the internal control system should be reviewed on an annual basis to confirm its effectiveness, and a report made to shareholders on the status of the review.

In June 1999, the World Bank Group signed an MoU with OECD, aimed at sponsoring the Global Corporate Governance Forum which was meant to collate several parties including development banks, bilateral organisations, and international organizations, among others, with a view of providing a rapid prompt response and coordination of assistance channeled to specific entities and countries. The forum was also designed to mobilize the private sector, both local and international with a view of further developing progressive corporate governance policies.

In 2003, Derek Higgs was appointed by the UK government to independently evaluate the responsibilities of independent directors and audit committees. The review included board

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109 Hampel, R. Final report. (London: Gee, 1998). The Committee recommended at least twenty corporate governance principles which were essential for good corporate governance. It advocated for the definition of the roles of directors and separation of the positions and responsibilities of the CEO and the Board Chairman. The Report also recommended that independent directors should be involved in nominating directors for appointment, fixing the pay for executives, among others.


effectiveness considering whether the presence of independent directors have an impact on the financial performance of public companies.\textsuperscript{112}

A Combined Code of Corporate Governance which included some aspects of the recommendations of the Cadbury Report, the Greenbury Report, the Hampel Report and the Higgs Report was produced in 2003.\textsuperscript{113}

2.3 History of Corporate Governance in Africa

The need for Corporate Governance better Corporate Governance practices in Africa was ignited by a World Bank Report which was released in 1989.\textsuperscript{114} The report termed corporate governance in Africa as a crisis of self-governance because state officers had been serving their interests when it comes to management of companies without fear of being held to account by either the people, opposition leadership or any other international body.\textsuperscript{115} The only countries that the World Bank identified as being true democracies were Botswana, Gambia, Mauritius and Namibia. The International body asserted that good governance contributes greatly to prosperity of corporations and that the converse was also true.\textsuperscript{116} In light of this report, many donors started factoring in governance considerations before funding developing countries. As such, there was instant need for African countries to embrace good corporate governance practices if they were to continue receiving aid from multinationals and foreign countries.\textsuperscript{117}

The most notable manifestation of corporate governance awareness in Africa was exhibited in South Africa in 1994.\textsuperscript{118} The King Reports have been widely embraced across Africa since they

\textsuperscript{112} The review recommended that a clear definition should be made of independent directors, taking into consideration the dealings and interactions that may affect the objectivity and impartiality of a director. Recommendation that 50% of the board should comprise independent directors was also made
\textsuperscript{113} Combined Codes of Corporate Governance (2003) known as UK Corporate Governance Code (2012). The Combined Code incorporated the corporate governance principles; the responsibilities of the board and chairman, responsibilities of independent directors as well as the constitution and responsibilities of audit and remuneration committees, among others,
\textsuperscript{116} Ibid
\textsuperscript{117} Shepsle, Kenneth A., 1999, Harvard University, “The Political Economy of State Reform – Political to the Core”, Centennial Lecture at the London School of Economics and Political Science, February 1999
\textsuperscript{118} In 1994, the Institute of Directors of Southern Africa published the first King Report in which the development of the country’s stock market was analysed. This report was later replaced in 2002 when the second King Report
majorly focus on sustainability of the corporations as opposed to protecting the investors. In South Africa, the reports are applied in the contexts of all corporate entities regardless of whether they are privately or publicly owned. Many statutes in the continent have been enacted in the spirit of the King Reports since the recommendations therein suit many countries. \footnote{119}

The African Union in its inaugural summit adopted the ‘Declaration on Democracy, Political and Economic and Corporate Governance.’ \footnote{120} The conception of corporate governance in this document emphasizes on inclusive participation of the stakeholder. With a view of enhancing government, the African Union also adopted an MoU on APRM in 2003. This memorandum suggests that member countries ought to evaluate themselves in respect to corporate governance and this evaluation would be peer reviewed by a team of other member states. \footnote{121}

Lately, the corporate governance reform agenda has been widely embraced in Africa as evidenced in many published reports. \footnote{122} These reports point to a concerted effort by African countries to try and achieve corporate governance reform. Given that Africa is the second largest Continent in the world, boasting of a population of over one billion, and plenty of raw materials, which have been taken advantage of by the European nations; its economic development is likely to have a serious

impact on the global economic index.\textsuperscript{123} As such, it is imperative that corporate governance be improved in the Continent. It is therefore important that a robust corporate governance structure is put in place in a bid to achieve the desired in flow of investment in Africa.\textsuperscript{124}

2.4 History and Evolution of Corporate Governance in Kenya

Trade liberalization in the 1980s and early 1990s was part of an agenda to make the market forces have a greater influence in the economy by reducing the government’s influence in the economy.\textsuperscript{125} In addition to liberalizing the market, the government also embarked on a program to privatize government entities.\textsuperscript{126}

Privatization of government entities brought about new aspects in the market place with floatation of shares to the public.\textsuperscript{127} The public subscribed for the shares enthusiastically. The need to establish good corporate governance practices to enhance protection of investors became more acute.

The urge to establish the principles of corporate governance in Kenya commenced with a workshop to review the role of non-executive directors in November 1998.\textsuperscript{128} The workshop was

\textsuperscript{123} Lawal, G. ‘Corruption and Development in Africa: Challenges for Political and Economic Change’ Humanity & Social Sciences Journal. 2007 Vol. 2, Issue 1. 1-7

\textsuperscript{124} Ibid


\textsuperscript{126} In 1992, the Government issued Policy Paper on Public Enterprise Reform and Privatization which was revised in in 1994 and 1998. The paper set out the scope of the Public Sector Reform Programme institutional framework and the guidelines and procedures for privatizing Public Enterprises. The Policy Paper identified 240 commercial Public Entities with public sector equity participation and classified them into two categories: 207 Non-strategic commercial Public Entities which were to be privatized and 33 Commercial Public Entities which were to be re-structured and retained under public sector control. However, by the end of the first phase of the privatization programme in 2002, most of the non-strategic commercial enterprises had either been fully or partially privatized. Between 2003 and 2007, the Government implemented a number of key privatization transactions which included the Kenya Electricity Generating Company (KenGen) Initial Public Offer (IPO), the concessioning of the Kenya Railways operations, Mumias Sugar Company Second Offer and Kenya Reinsurance Corporation IPO.

\textsuperscript{127} Supra note 73 p 159

\textsuperscript{128} Private Sector Governance Trust, Principles for Corporate Governance in Kenya and a sample code of Best Practice for Corporate Governance (Nairobi 1999).
sponsored by among others, the NSE\textsuperscript{129}, CMA\textsuperscript{130} and ICPAK.\textsuperscript{131} The workshop resolved that another forum be convened to deliberate on the many issues that emerged, which was organized to discuss principles of good corporate governance. Following these initiatives, the Private Sector Governance Trust was formed in 1999 to address the issues concerning corporate governance in Kenya.\textsuperscript{132}

In 2012, CMA initiated a review of the 2002 Guidelines bearing in mind, the developments that had occurred since the issuance of the Guidelines in 2002.\textsuperscript{133} The review culminated in the enactment of the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.

\textbf{2.5 A highlight of the Corporate Governance Framework in Kenya}

In view of the progressive historical developments in the corporate governance, the corporate governance framework in Kenya has significantly developed to comprise the laws and regulations that sets out the requirements for the formation and closure of firms and their operations in Kenya.\textsuperscript{134}

The laws and regulations provide a framework setting out rules and guidelines by which various listed companies should be directed and managed and how disputes should be resolved. In situations where there is no effective legal protection, it is unlikely that investors will provide capital in exchange of a promise of a return because if the promise is not kept, the investor has no fallback position. La Porta concluded that jurisdictions that have effective legal systems have a

\begin{itemize}
\item \textsuperscript{129} Nairobi Securities Exchange is a licensed securities exchange where trading of securities of listed companies is done.
\item \textsuperscript{130} The Capital Markets Authority regulates the listed companies in Kenya, among other responsibilities.
\item \textsuperscript{131} The Institute of Certified Public Accountants of Kenya (ICPAK) regulates the accounting profession in Kenya.
\item \textsuperscript{132} The Trust released a Code of Best Practices for Corporate Governance as a guide for good governance practices in Kenya. The Guidelines on principles of corporate governance for public listed companies came into effect in 2002 in a bid to institutionalize good governance in listed companies.
\item \textsuperscript{133} CMA initiated the review of the guidelines through the appointment of a nine-member Capital Markets Steering Committee on Corporate Governance in December 2012. The Committee held stakeholders’ engagements and drafted the Corporate Governance Code in 2014 which was subsequently gazetted in 2016 as the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.
\item \textsuperscript{134} Diane K. Dennis, ‘International Corporate Governance’; accessed in http://docs.lib.purdue.edu/cgi/viewcontent.cgi?article=1016&context=ciberwp
\end{itemize}
higher likelihood of getting investors than their counterparts. Corporate governance in listed companies in Kenya by several pieces of legislation which were developed as a result of the protracted policy adjustments in the sector.

2.5.1 Constitution of Kenya, 2010

The Constitution of Kenya is the greatest of all the laws in Kenya. Article 10 of the Constitution requires that every person should respect, abide by and defend the constitution. The constitution embraces good governance principles, including transparency and accountability. Transparency denotes the degree of clarity and openness in corporation’s dealings and entails enabling outsiders to scrutinize the operations and activities of a company by availing accurate information to such outsiders. Accountability denotes the act of being held responsible for one’s actions.

The principles as recognized by the Constitution are crucial and fundamental to corporate governance. They are recognized as the main principles of corporate governance. The Constitution is crucial in enhancing good corporate governance in management and direction of companies in Kenya and cannot be overlooked. It is important to ensure that existing legislation is aligned to the provisions of the Constitution.

2.5.2 The Companies Act

The legal regime of corporate governance in Kenya is embodied in the Companies Act, 2015. The former Companies Act had many shortcomings and had to give way to a more progressive framework.

Following the enactment of Companies Act, 2015, Kenya has made a major step in reforming its company laws to match global standards. The Act has transformed the way in which companies

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136 These include the Constitution of Kenya 2010, the Companies Act, the Capital Markets Act and the Guidelines issued thereunder.
138 The Constitution defines a person to include a company, an association or other body of persons. In view of the foregoing, the management and direction of public companies should be consistent with the provisions and the intention of the constitution.
139 Article 10 of the Constitution.
140 Chapter 486, Laws of Kenya;
are to be run especially in terms of defining terms of reference as regards directorship, rights of shareholders, general meetings, institution of derivative actions and the financial reporting and auditing requirements, among others.

The Act further recognizes the role of shadow directors, who may not have a specific official role in the company but nonetheless wield a lot of power and influence towards management of the company.

2.5.3 The Capital Markets Act

The Capital Markets Act is the statute that regulates listed companies and securities markets. The CMA which regulates the players in the capital markets is set up under the Act. The objectives of the Act include development and deepening of the capital markets, investor protection as well as creation of a market where trading of securities is done fairly, orderly and in an efficient manner, among others.142

In order to carry out its objectives, the Act mandates CMA to, among others, prescribe notices or guidelines on corporate governance practices to companies that have issued securities to the public.143 CMA issued Guidelines on principles of corporate governance for public listed companies in 2002 in an attempt to institutionalize corporate governance in Kenya.144 The new Code is the basis of our study and we shall review it in the next chapter.

In addition, CMA developed the 2014-2023 Capital Markets Master Plan which sets out the plan of capital markets in Kenya in the next 10 years in supporting the economic growth of the country. The Master Plan foresees that Kenya will be the prime destination for issuers and investors looking for investment opportunities in Kenya or across Africa.

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141 The Act concisely provides for issues of appointment, remuneration, powers, code of conduct and governing rules as well as the place of non-executive directors.
142 Capital Markets Act, S. 11(1)
143 Ibid Sec. 11 (3)(v)
144 In 2012, CMA set up a committee which developed a Corporate Governance Blueprint for Kenya and a Code of Corporate Governance for Issuer of Securities to the Public. The Code of Corporate Governance was gazetted in March 2016 which repealed and replaced the 2002 Guidelines on corporate governance practices for listed companies.
The Plan has three pillars and nine building blocks which are the basis for the main strategic initiatives. The foundational pillar focuses on bolstering the regulatory and legal environment that is necessary to support the capital markets. This includes boosting the regulator’s capacity and providing an enabling and competitive environment for innovation to thrive.

As a regulator of listed companies, CMA has taken various actions in regard to listed companies with corporate governance scandals over the years. In September 2011, the shares of CMC Holdings were suspended from trading at the NSE following claims of failure by the company to comply with good governance. Allegations of conflict of interest and fraud were made against CMC directors which caused scare and uncertainty in the market.\textsuperscript{145} CMA carried out an inquiry on the allegations made and some weaknesses were observed which led to the commissioning by CMA of an independent investigation. Following the investigations and representations made to CMA, it issued enforcement action to CMC as well as its former directors and officers who were found culpable. The enforcement action by CMA gave rise to several suits against CMA.\textsuperscript{146}

There have been allegations that interventions by CMA come too late and lack the necessary depth and breadth to engender investor confidence.\textsuperscript{147} It is imperative that CMA is more proactive in taking steps to safeguard to secure investor’s interests.

2.6 Conclusion
Gradual but significant progress in the domain of corporate governance have occurred across the world. Most of these developments came into place to address or react to the numerous corporate

\begin{itemize}
\item [\textsuperscript{145}] CMA; Report and Resolutions of the Board Of The Capital Markets Authority Regarding The Investigation Into The Affairs Of CMC Holdings Limited, 3 August 2012. The report details the events from suspension of trading of shares to the regulatory action taken on the company, directors and officers in relation to the corporate governance deficiencies
\item [\textsuperscript{146}] In Jeremiah Gitau Kiereini v Capital Markets Authority & another [2013] eKLR, Mr. Jeremiah Kiereini filed a petition at the High Court challenging CMA’s enforcement action against him. The Court quashed the report and resolutions by CMA regarding the investigation into the affairs of CMC in so far as they related to the petitioner on the grounds that the CMA board did not afford the petitioner an opportunity to be heard before taking the enforcement action against him. CMA appealed against this judgment in Capital Markets Authority v Jeremiah Gitau Kiereini & another [2014] eKLR and the appeal court reiterated that Article 47 of the Constitution was breached since Mr. Kiereini was not given the opportunity to be heard before sanctions and other penalties were imposed on him. In Republic v Capital Markets Authority Exparte Joseph Mumo Kivai & another [2012] eKLR, CMA filed an application seeking to set aside orders of stay for the enforcement actions taken by CMA which orders had been obtained by Mr. Peter Muthoka and Mr. Joseph Kivai. The court allowed CMA’s application and set aside the stay orders.
\item [\textsuperscript{147}] See CMA regulatory actions should uphold shareholder interest but is that the case? 14\textsuperscript{th} February 2012, The Standard, available at https://www.standardmedia.co.ke/article/2000052051/cma-regulatory-actions-should-uphold-shareholder-interest-but-is-that-the-case accessed on 4\textsuperscript{th} July 2018
\end{itemize}
scandals that the world has been experienced. With each stage of development, new laws are created including regulations and codes both at a national, regional, sector specific and international level.

Corporate governance was a principles-based voluntary approach whose initial thought was to create a self-regulated industry. Many countries have now adopted rules-based regulations with a view of rectifying the flaws in the initial concept of self-regulation. The application of corporate governance principles have also increased from being applied to listed companies to being adopted in organisations in all sectors, be it private, public and not-for-profit, so that schools, hospital and faith-based organisations.

Several companies in Kenya have had governance failures, especially during the period that the repealed Companies Act, Cap 486 was effective. While the Act is not wholly to blame for the collapse, poor corporate governance has contributed and continues to contribute to the failure of many corporations to date.

A review of company’s legislation to reflect the market conditions in Kenya today began with the enactment of the Companies Act, 2015 and the Code. However, much more is required to be done so that the new laws and regulatory framework achieves the intended objectives.
CHAPTER 3

AN ANALYSIS OF THE CODE OF CORPORATE GOVERNANCE PRACTICES, 2015
AS AGAINST OTHER CORPORATE GOVERNANCE LEGAL INSTRUMENTS

3.1 Introduction

Many studies reveal that where corporate governance is functional effectively, two benefits result; the investor confidence grows since the investors are assured of the return on investment owing to good management; secondly, the actual profits are indeed returned to investors and it is easy for such companies to access credit from financiers. In principle, companies which embrace high standards of corporate governance practices attract more investors than those which do not. It is noteworthy that an ineffective corporate governance system creates opportunities for managers to divert assets to personal aims that do not benefit the investors.

In Kenya, debate on corporate governance gained prominence following major corporate scandals causing the collapse of large state corporations in 1990s. Towards the end of 1998, a workshop to review the roles and responsibilities of non-executive directors was held bringing together participants from the NSE, CMA and ICPAK among others.

In 2002, guidelines on principles of corporate governance for public listed companies were issued in a bid to formalize good governance practices in listed companies. There are various laws governing corporate governance in Kenya.

The Companies Act provides the basis of corporate governance by setting out how the requirements for board structure and the role of directors, etc. The Capital Markets Act gives the CMA power to regulate listed companies and those that issue securities to the public although they

148 Supra note 4 p. 737
149 Report of the Committee on Financial Aspects of Corporate Governance (1992) para 1.6
150 Examples of parastatals that collapsed include Kenya Cooperative Creameries (KMC), Kenya Meat Commission (KMC), Kenya National Assurance Company Ltd, among others.
151 Supra note 128. Following this initiative, the Private Sector Governance Trust was formed in 1999 to review and recommend the way forward on the issues of corporate governance in Kenya. It then proceeded to release a Code of Best Practice for Corporate Governance to act as a guide for corporate governance practices in Kenya.
152 Supra note 61
153 These include the Companies Act, No 17 of 2015, the Capital Markets Act, cap 485A and to a lesser extent, the Penal Code, Cap 63, Laws of Kenya
are not listed. The CMA formulated the Guidelines on corporate governance practices by listed companies in Kenya, 2002.\textsuperscript{154} The guidelines established the legal framework for corporate governance in Kenya. It was envisioned that the guidelines would enhance investor confidence and improve transparency in Kenya’s capital markets.\textsuperscript{155}

The Penal Code provides for strict penalties on trustees who deal with trust property fraudulently but directors are not included in the description of the term—trustee.\textsuperscript{156} However, sometimes, directors are deemed as trustees.\textsuperscript{157} The Penal Code has other provisions which provide for penalties on directors for the offences of fraudulent accounting or appropriation\textsuperscript{158} or providing erroneous information with the intention to mislead or swindle the company\textsuperscript{159} but these are rarely initiated.

Despite the 2002 Corporate Governance Guidelines, corporate governance scandals have occurred among companies such as CMC Holdings Limited\textsuperscript{160}, Uchumi Supermarkets Limited\textsuperscript{161} and

\textsuperscript{154} This was done through Gazette No. 3362 of 2002
\textsuperscript{156} Penal Code, Cap 63, Laws of Kenya, S.327
\textsuperscript{157} First, directors are viewed as trustees of the company assets which is under their control. See Re Forest of Dean Coal Mining Co. Ltd (1878) 10 Ch.D. 450. Second, money in a company bank account which directors are authorized to operate is held in trust for the company. See Selangor United Rubber Estates v. Craddock [1968] 1 W.L.R.1555. However, directors are not trustees’ sensu stricto because unlike ordinary trustees whose primary obligation is to preserve trust property, directors on the other hand are bound to invest for the benefit of the company. Second, while ordinary trustees have legal title in the property of the beneficiary, directors do not since it is vested in the company.
\textsuperscript{158} Supra note 156 S.328
\textsuperscript{159} Supra note 156 S.329
\textsuperscript{160} On September 16, 2011, CMA suspended CMC Holdings Limited shares from trading at NSE following allegations of non-compliance with corporate governance, conflict of interest and fraud against certain directors of CMC causing scare and uncertainty in the market. Although the suspension of shares was initially for a period of seven days, the period was subsequently extended until June 2013 when the majority shareholders sold their shares to Al Fontain which led to the company getting delisted from the securities exchange.
\textsuperscript{161} CMA suspended Uchumi shares from trading in the NSE in May 2006 after it was declared insolvent and put under receivership by its lenders. In 2008, several persons were charged in court for insider trading and with the offence of conspiracy to defraud Uchumi. However, after trial, none of the accused persons was convicted. CMA allowed back trading of Uchumi’s shares in NSE in 2011 following evidence of turnaround to profits. However, this was short-lived, as in 2015, the company experienced liquidity problems where senior managers were accused of having conflict of interests and ingenious accounting leading to material misstatements in the financial reports. The board and senior management was reconstituted and a forensic investigation was undertaken. CMA also conducted an inquiry into the affairs and operations of the Company and took enforcement action on the board of directors, the CEO and the Finance Manager for the corporate governance lapses that they identified.
Mumias Sugar Company Limited among others. Some of these cases are a consequence of weak corporate governance practices, fraud and negligence in management of shareholder funds.

Over time, CMA recognized the need to review the existing corporate governance framework, especially in view of developments that had occurred since the issuance of the corporate governance Guidelines in 2002. The developments prompted a need to rethink the corporate governance issues in a bid to guard against perils that could impend the financial system. In December 2012, CMA appointed a Steering Committee on Corporate Governance to regularly review the standards of corporate governance for listed companies in order to abide to the international practices and developments.

In March 2016, the Code of Corporate Governance practices for Issuers of Securities to the Public, 2015 was gazetted. Innovatively, the 2015 Code replaced the corporate governance guidelines issued in 2002. The code is applicable to companies listed at the NSE and those that offer securities to the public even if they are not listed.

This Chapter examines the Code to assess whether it is likely to address the emerging corporate governance challenges in listed companies. The chapter will commence with a background of the Code and then to review some of the provisions in the Code and how they are expected to address the corporate governance challenges.

The repealed 2002 guidelines provided for seven principles of good corporate governance. The Code comprises seven chapters, starting with the introduction.

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162 Challenges with Mumias were attributable to mismanagement of the company and fraud/corruption amongst senior management. Poor performance of the company was blamed on a number of factors, including illegal sugar imports that led to a reduction of the commodity’s price, cane poaching by the competitors and shutdown of its plant.


165 The Code is known as the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.

166 These were: an effective board which was expected to give strategic guidance, steer the company and account to its shareholders; separation of the roles of chairman and the chief executive officer; shareholder participation in decision-making of the company; accountability and audit; as well as general principles relating to public disclosure, auditors, company secretaries and chief financial officers of listed companies.

167 The other Chapters are board operations and control, rights of shareholders; accountability, risk management and internal control and transparency and disclosure.
The 2015 Code contains the broad principles underpinning corporate governance. It also contains the recommended practices for adoption by companies for their processes. In addition, the Code has guidelines aimed at helping companies to understand the recommendations and provide guidance in implementation of the principles.

The Code has an expanded scope as it applies to both companies that are listed and those that are not listed but issue securities to the public. Other companies though not expected to abide by the Code are encouraged to adopt it as a matter of best practice.

3.2 A review of the Code
The Code has shifted from the comply-or-explain approach to the apply or explain approach.\textsuperscript{168} The first country to adopt the apply-or-explain approach was Netherlands.\textsuperscript{169} In Africa, South Africa first used the apply-or-explain model in 2009 when King III Report was published.

In comply-or-explain approach, if a company provided an explanation, this meant that it had not complied with some principles or codes.\textsuperscript{170} Therefore, the offering of an explanation was tantamount to non-compliance. In order to address this, the approach was renamed as apply-or-explain. In this approach, a company may apply the prescribed codes or explain why they were not applied and both become acceptable ways of compliance.\textsuperscript{171} The apply-or-explain approach recognizes that organisations are at different levels of growth and therefore require different set of rules depending on the level of growth of each company.

The Code allows the boards to be flexible in making decisions but is focused on ensuring that decisions are made while applying the high governance standards as recommended in the Code. It is however expected that a company that does not implement the requirements of the Code should explain the reasons why it opted not to apply the requirements.\textsuperscript{172} It is however worth noting that

\textsuperscript{168} The comply-or-explain model was the approach used in the repealed 2002 corporate governance guidelines. The apply-or-explain approach is a revised form of the comply-or-explain approach that takes into account the challenges of the comply-or-explain approach.
\textsuperscript{170} Ibid
\textsuperscript{171} Supra note 169 p. 3
\textsuperscript{172} Miroslav Nedelchev, ‘Good Practices in Corporate Governance: One-Size-Fits-All vs. Comply-or-Explain’; Corporate Governance, International Business School, Chiprovtsi 7 – 1303 Sofia, Bulgaria
whereas the Code adopts the apply–or-explain approach, some of the provisions are mandatory and companies must comply with them.

Companies were expected to implement the Code within one year of its gazettement and those that had not applied had to disclose to the CMA, the reasons for non-implementation, indicating the time-frame required towards its full implementation.¹⁷³

### 3.2.1 Board of Directors

The board is the main governing body in a company and is responsible for the strategic direction of the company.¹⁷⁴ The Code sets out ten principles aimed at ensuring that the board is made up of skilled and experienced members who can make impartial judgement and direct the formulation of strategy, among others.¹⁷⁵ This is an improvement in comparison with the 2002 corporate governance guidelines which only provided for one principle.¹⁷⁶

The change is a result of realization that the board is the most critical institution in corporate governance. Corporate governance scandals in some public companies in Kenya have been blamed on ineffective board of directors. For example, following an inquiry into the affairs of CMC, the CMA Board concluded that the CMC board failed to exercise effective oversight over those managing the company.¹⁷⁷ The CMC board had established that there were grave weaknesses in the internal controls of the company and commissioned an internal audit assessment by an audit firm, Deloitte East Africa. However, the board failed to oversee the execution by management of the recommendations made by the audit firm.¹⁷⁸

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¹⁷³ It is a requirement for companies to disclose to the shareholders the status of implementation of the Code.
¹⁷⁵ Code of Corporate Governance Practices by Issuers of Securities to Public, 2015, Chapter 2-Board Operations and Control.
¹⁷⁶ The 2002 corporate governance guidelines had one principle under Board operations and control, that every company must be headed by an effective board which should offer strategic guidance, leadership and control of the company and should be accountable to the shareholders.
¹⁷⁷ Supra note 145
¹⁷⁸ Ibid
The near collapse of Uchumi Supermarkets was attributed to a dysfunctional board\textsuperscript{179}. In \textit{Republic Vs Lloyd Masika and Uchumi Supermarkets and 13 others,}\textsuperscript{180} some directors were charged with the offence of conspiracy to defraud Uchumi and breach of public trust. Even in developed countries where corporate governance is well established, dysfunctional boards have been associated with governance failures. In the case of Enron, directors were found to have failed in checking the activities of management of Enron and its financial affairs by failing to interrogate the information given to them because they trusted management.\textsuperscript{181}

Factors that contribute to board effectiveness include; the role and responsibilities of the chairman and independent directors, board diversity, information flows to the board, and board evaluations among others. The Code provides that the Board should set up its roles and responsibilities required in order to perform its functions.\textsuperscript{182} A director does not need to act in the interests of shareholders if this contradicts with the company’s interests. For example, shareholders may want dividends to be paid which may not be in the interests of the company, as it could be planning to expand or it may not have the liquidity. In such a case, directors should refuse to recommend payment of dividends despite the shareholders’ opinions.

Some of the corporate governance scandals in Kenya are said to have been caused by a failure by the directors to carry out their fiduciary duties, conflicts of interests and fraud. A case in point is that of some directors of CMC Holdings who were accused of operating offshore arrangements and benefitting from these arrangements in contravention of fiduciary duties owed to the

\textsuperscript{179} Eshiwani, ‘Director Liability in the Wake of Uchumi (Collapse)’, Institute of Directors (Kenya), July 14, 2006.
\textsuperscript{180} Republic Vs. Lloyd Masika and Uchumi Supermarkets and 13 others Criminal Case No. 900 OF 2008 The criminal charges arose from the alleged irregular sale of Uchumi Supermarket, Aga Khan Walk branch that was sold to Allgate Limited for Ksh147 million and then leased back to the chain at an inflated monthly rent of Sh1.7 million. The former chairman, businessman Chris Kirubi in his defence claimed that at the time, the company was facing financial crisis and had resolved to sell its asset in order to inject funds into the company. He argued that Uchumi had power to acquire and dispose of property, sell and lease back premises it had disposed of and maintained that the decision to sell the premises was supported by the management and the government through the Permanent Secretary in the Ministry of Trade who was kept abreast of the happenings.
\textsuperscript{182} Supra Note 175 Recommendation 2.3.1. In exercising fiduciary duties, the directors must among others, use skill, care and diligence and act, not for their own interests but for the company’s best interests. They should act honestly, avoid situations whether their own interests contradict with the company’s interests and exercise independent judgement.
shareholders and this was proven following investigations and representations made to the CMA board by some of the directors.\textsuperscript{183}

The Code does well to capture in great detail, the duties of directors. Considering that the Companies Act has codified director’s duties and the provisions in the Code on directors’ duties, it is anticipated that the provisions will resolve the challenges previously experienced with corporate scandals especially where directors are discovered to have flouted their fiduciary obligations.\textsuperscript{184}

The Code provides that the Board should comprise a balance of executive\textsuperscript{185} and non-executive directors.\textsuperscript{186} At least a third of the directors should be independent non-executive.\textsuperscript{187} This provision is similar to that contained in the repealed 2002 corporate governance guidelines.

However, the role of non-executive and independent directors is not clearly stated in the Code. This is an area that requires further improvement so that it is clear to the members being appointed as non-executive directors what their role entails. This will also assist in designing appropriate training to those appointed as non-executive directors. The experience elsewhere reveals that there is value to be obtained in clarifying the role of non-executive directors.\textsuperscript{188}

\textsuperscript{183} Supra note 177. In addition, some of the directors were found to have breached fiduciary duties by implementing a precarious business practice for the company of borrowing to lend and failing to implement a process to monitor and manage the risks associated with the practice of borrowing to lend.

\textsuperscript{184} The Companies Act, 2015 has codified director’s duties, and it is possible for directors to be charged with the offence of breaching the statutory duties where there is evidence of breach.

\textsuperscript{185} Supra note 179, Recommendation 2.1.3. An executive director is defined as a member of the board who also serves as a manager of the company.

\textsuperscript{186} A non-executive director is defined as a member of the board who is not part of the management team and is not an employee of the company or affiliated with it but can own shares in the company.

\textsuperscript{187} An independent director is defined as one who has no material or pecuniary relationship with the company and is compensated through sitting fees and allowances, does not own shares in the company and has served as a director for a continuous period of up to nine years. If he continues to serve as director after nine years of service, he ceases to be an independent director and assumes the position of a non-executive director.

\textsuperscript{188} The UK Corporate Governance Code is clear on the role of non-executive directors. It states that their roles are; to guide the formulation of strategy; monitor the implementation by management of the agreed actions and objectives; and monitor management’s reporting of performance. Further, in a study conducted on UK listed companies to investigate whether independent directors have a role in determining firm performance, the results indicated that the presence of independent directors on the board exerts a positive role on the corporate value. This was attributed to the role played by non-executive directors. See Roberto Mura, Firm Performance: Do non-executive Directors have a mind of their own? Evidence from UK Panel Data available at http://www.efmaefm.org/0EFMA%20ANNUAL%20MEETINGS/2005-Milan/papers/179-mura_paper.pdf accessed 3rd July 2018.
However, several barriers have been identified which makes it difficult for non-executive directors to effectively perform their roles including; the lopsidedness of the information being held by the executive directors’ vis a vis the information provided to the independent directors which they are required to rely on when carrying out their monitoring and supervisory functions. All information is in the hands of executive directors and they can choose what information to give to the non-executive, which may not be complete. Therefore, there is need to state clearly the roles and responsibilities of non-executive and independent directors in the Kenyan context. It is also important to state how the roles and responsibilities are to be carried out.

Additionally, the Code expects the Boards of Directors to come up with policies including the diversity policy; the risk policy, the remuneration of directors’ policy, shareholder communication policy, related party transaction policy, conflict of interest management policy, voting policy, whistle blowing policy, corporate social responsibility policy, information technology policy and the procurement policy. However, it is silent on the specific salient ingredients of each of the policies particularized. It is important that a standardized approach to the contents of the policies is adopted to ensure there is uniformity in the implementation of the policies.

The Code requires that the Boards shall be of sufficient size. However, it is silent on the pointers that will serve as guidance for determining board sizes. It only providers that the Board should not be too large as to inhibit proper discussions over the issues raised and not too small as to lock out the much needed expertise and professional contributions. These recommendations leave it too open for individual companies to decide the size of the Board and there cannot be harmony especially in the board sizes of companies with similar governance structures and sophistications may have highly disparate board sizes. The Code falls short by not stipulating parameters that should precisely inform the sizes of respective boards.

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189 Jonathan Liu & Thomas Anderson, ‘Mind the Gap: Expectations on the Role of UK Non-Executive Directors.’ Regent’s Working Papers in Business & Management 2014 Working Paper 1402, 3-4. Another barrier which stand in the way for non-executive directors to fulfil their role is that they have limited time especially in view of the fact that directorship is not a full-time function.

190 Supra note 175, Recommendation 2.1.4
3.2.1.1 Multiple Directorships

The Code provides for a maximum number of other directorships a board member can have at any time.\(^\text{191}\) This is to ensure that directors are available and effectively contribute in the board. The number of directorships by board members has been reduced from the previous five (5) directorships as stipulated by the 2002 Guidelines to three (3). This is to reaffirm the need for effective participation by the directors in the board.

Criticisms have been made regarding the efficacy of having directors sitting on several boards.\(^\text{192}\) It has been argued that it in fact inhibits the capacity of the directors to effectively scrutinize the management and carry out the strategic work of the board.\(^\text{193}\) This is due to the fact that a director may be too busy attending to the various boards that he may not have adequate time for each of the companies. With the ever-increasing responsibilities of directors, there is need for directors to create adequate time to carry out their duties. Conversely, the argument for multiple directorships is that directors with multiple directorships are better connected and have a wider experience to various organizational practices and different operating environments.\(^\text{194}\) These diverse experiences help the directors to add value to the board decisions. The prevailing position though is that multiple directorships may lead to time limitation thus making the director ineffective; and therefore, the need to cap the number of other directorships by the directors.

3.2.1.2 Board Audit Committee

The Code provides for constitution of committees of the board, especially audit and nominations committee.\(^\text{195}\) The audit committee is mandated to oversee the financial reporting processes, instituting internal controls and ensuring compliance.\(^\text{196}\) The audit committee should ensure that

\(^{191}\) Supra note 175, Recommendation 2.1.6
\(^{193}\) Ibid p. 2
\(^{194}\) Supra note 192 p. 137
\(^{195}\) Supra note 175, Recommendation 2.2.4 requires that chairpersons of the Board Committees should be independent directors. Committee members should be independent directors. The audit committee should have one member with a professional qualification in audit or accounting.
principles of integrity and transparency are in place especially between the auditors and management where open discussions are held.  

The repealed 2002 corporate governance guidelines provided for the constitution of the audit committee by listed companies. A study conducted in year 2008 on 29 companies listed in Kenya’s security exchange showed that 93% of those companies had implemented the recommendation.

Despite this, it is notable that a majority of the companies with corporate governance scandals had issues with integrity of financial reports and the internal audit function. In the case of CMC Holdings, the investigations commissioned by the CMA revealed that the internal audit function of the company was weak. In addition, the board had signed off accounts that were not compliant with International Financial Reporting Standards. A forensic audit on Uchumi conducted by KPMG in 2015 disclosed that the company manipulated the accounting entries, leading to misleading financial information. In both companies, audit committees were in place in compliance with the guidelines.

A lot of emphasis has been placed on the role of the audit committee in enhancing corporate governance. The Companies Act, 2015 requires public listed companies to set up audit committees which are tasked with internal audits of operations of the corporation. Studies conducted in Nigeria and Malaysia show that effectiveness of an audit committee has a positive influence on the financial performance of a firm.

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197 http://www.cpab-cccrc.ca/en/topics/RoleAuditCommittee/Pages/default.aspx accessed 22 July 2017. The performance of auditors is reviewed by the audit committee. The audit committee should scrutinize the audit strategy and ensure that it addresses the major audit risks. The committee should ensure that auditors apply professional skepticism in carrying out the audit; and that they are independent of management and impartial.

198 Supra note 59, p. 30

199 Supra note 176 p. 12

200 Forensic audit conducted on Uchumi in 2015 revealed incidents of possible misstatements in the audited financial statements for financial years 2010 to 2014 published to the investing public for purposes of making investment decision and CMA, while conducting independent investigation summoned the auditors to show cause why action should not be taken against them. See Ernst & Young LLP v Capital Markets Authority & another [2017] eKLR/.

201 A study conducted in Nigeria trying to establish the link between audit committee effectiveness and the firms’ performance showed that certain measures of audit committee effectiveness (such as audit committee independence, audit committee financial expertise and board size) significantly influence the firm’s financial performance. See Ojeka Stephen Aanu, Iyoha Francis Odianosen & Obigbemi Imoleayo Foyeke, ‘Effectiveness of Audit Committee and Firm Financial Performance in Nigeria: An Empirical Analysis’ Journal of Accounting and Auditing: Research & Practice; Vol. 2014 (2014) 1-12 available at http://ibimapublishing.com/articles/JAARP/2014/301176/301176.pdf accessed 8th August 2017. Another study conducted to examine the relationship between audit committee characteristics and firm performance based on selected listed companies in Malaysia found significant association between audit committee characteristics and firm performance and also with audit quality. However, the study showed that not all the audit
It is important to ensure that requirements on audit committee are implemented so that the benefits can be realized in our listed companies. It is however unclear, how the Capital Markets Authority intends to enforce the requirement against Companies which do not embrace robust Corporate Governance structures. The other major challenge that has been identified is the fact that users of financial statements of these corporations are not keen on getting the particular details regarding the financial progress of the companies in question. This promotes laxity on the part of the audit committees.202

3.2.1.3 Conflicts of Interest

Directors owe fiduciary duties to the company and as such, they must avoid situations that could lead to a conflict between their own interests and their duties to the company. This principle was propounded by in Bray –v- Ford.203

Directors cannot therefore reject an offer of a third party for the benefit of the company and proceed to accept the same offer for their own benefit. This would amount to creating an opportunity for self-centered behaviour. One cannot do business with the company for his own benefit and at the same time be expected to be diligent in performing his duties as a director in the same company. The duty of care is already compromised as he is likely to be more loyal to his own interests than to the company’s interests.

The Code requires companies to develop a policy to manage conflicts of interest.204 In addition, directors are required to make a declaration as to whether they have any conflict of interest upon

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202 Karugor Gatama ‘Launching Corporate Governance in Africa with an Emphasis on Kenya Private Sector Corporate Governance Trust’ (Center for International Private Enterprise, 2005).

203 (1896) A.C 44 HL 51-2. Lord Herschell observed that Lord Herschell observed that “It is an inflexible rule of a court of equity that a person in a fiduciary position……is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is…….founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those he was bound to protect. It has therefore been deemed expedient to lay down this positive rule.”

204 Supra note 175, Recommendation 2.3.8
appointment and any other time where circumstances so demand. Further, directors should recuse themselves from discussions regarding any transaction in which they are conflicted.

3.2.2 Protection of rights of shareholders

Although management policies of a company are made by the board, shareholder’s decision making is important in the governance of companies. Shareholders should monitor the board’s performance. The review is usually done through annual reports and accounts laid for consideration at the annual general meetings. If shareholders think that the performance of the board is not adequate, they take action, including replacing existing directors with new ones.

Shareholder activism, although dependent on individual enthusiasm, is also dependent on the availability of the rights of shareholders at general meetings and whether these rights are actually implemented. The Code provides for the protection of the rights of shareholders.

However, despite the existence of shareholder rights which are exercised at the annual general meeting, many shareholders in Kenya do not take annual general meetings seriously. This is in spite of the fact that important decisions are approved regarding the various development agendas at the annual general meetings. Some shareholders rubberstamp what they have little or no knowledge about at the annual general meetings.

Good corporate governance is premised on shareholders monitoring the actions of directors and it is important for shareholders to perform this role. The Code has detailed the rights of shareholders

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205 The Code requires that the Board should recognize, respect and protect the rights of shareholders, by facilitating the effective exercise of the rights of the shareholders. Chapter 3 of the Code sets out the rights of shareholders which include:

i. Right to relevant information on the company’s performance through distribution of annual reports and accounts and half yearly reports and directors are required to avail the reports across multiple communication channels including websites, postal mail and newspapers. The annual report should include highlights of the operations of the company and financial performance among others, companies are encouraged to organize regular investor briefings especially when half-yearly and annual results are declared.

ii. Right to receive relevant, sufficient and timely information on the date, location and agenda of the Annual General Meeting (AGM) as well as information on the issues to be decided during the AGM.

iii. Right to participate and vote at the general shareholders’ meeting, including election of directors. Shareholders are entitled to ask questions, seek clarification on any matter that is relevant to the company’s performance and receive an explanation from the directors and management.

206 Edwin Okoth ‘During AGMs shareholders are reduced to spectators’; The Standard Tuesday, June 21 2006.
which should be recognised, respected and protected\textsuperscript{207}. This is a positive step. However, much more need to be done, as it is possible that most shareholders are unaware of their rights. It is important to conduct awareness training to shareholders on their rights. This ensures that they are better informed and lead to better corporate governance practices in these companies.

\subsection*{3.2.3 Transparency and Disclosure}

Transparency and disclosure are important features of a good governance framework. They offer the basis for investors and potential investors to make well informed decisions relating to the financial performance of a company, among others.\textsuperscript{208} This is through the information availed to the investors and potential investors relating to the organisation.

The importance of transparency and disclosure is widely acknowledged by market regulators and this has resulted in introduction of rules and regulations to facilitate disclosure of timely and reliable financial information by companies to which they must adhere. Disclosure ensures that all relevant information is available to all who are interested in the company.

Corporate transparency describes the extent to which outsiders can observe a corporation's actions through the information availed by the corporation.\textsuperscript{209} Transparency helps management to avoid engaging in improper and unlawful actions since their conduct can be scrutinized and any improper behaviour is observed.\textsuperscript{210} Transparency lies between the right of members to access the information and the corporation’s right to privacy.\textsuperscript{211}

The OECD Principles\textsuperscript{212} provide that a good governance framework seek to confirm that all important matters about the organisation are timely and accurately disclosed. This includes information on the financial position, ownership and governance of the corporation.

\begin{thebibliography}{99}
\bibitem{207} Supra note 205.
\bibitem{209} Ibid p. 73
\bibitem{210} Supra note 208, p. 75
\bibitem{211} Supra note 208, p. 77. On one hand, the shareholders and other stakeholders are entitled to access information about a corporation’s actions. On the other hand, the corporation has a right to control the use and disclosure of all information about the corporation.
\bibitem{212} Supra note 44 Principle V
\end{thebibliography}
The Code recognizes that disclosure is an important tool that can influence the way companies execute their activities and secure the interests of investors. Disclosure have further been found to bring in the required capital besides maintaining the general level of confidence in the markets in which shares are traded. It helps stakeholders to understand the activities and policies of a company, in the same way that it relates with the communities that it operates within. Weak and opaque disclosure can lead to unethical behaviour which have the potential of resulting to loss of market integrity and investor confidence.

Disclosure has several challenges to contend with. It assumes that investors are capable of understanding and using the information provided to make decisions. However, it is worth noting that most ordinary investors are not technically competent to comprehend and apply the available information in decision making. Most of the investing public are not educated and do not take their position as shareholders of public companies seriously.

Disclosure presupposes that the required infrastructure for disclosure is in place, including presence of information analysts and investments advisors who will simplify the information for investors. However, this is not the case, especially in Kenya where financial literacy is still lacking. Disclosure assumes that decision makers are rational, which is rarely the case. Many investors and potential investors make irrational decisions. For instance, Initial Public Offers in Kenya have been exciting and many the offers have been massively oversubscribed not because the investors made rational decisions. There is therefore, no incentive to read the prospectuses.

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213 Supra note 175 Chapter 7, Transparency and Disclosure
214 Supra note 208, p. 76
Despite the challenges, the Board is required to build the culture of disclosing relevant information in a timely and adequate manner in information that has a bearing on the decision making of the company.\textsuperscript{219} Information to be disclosed includes;

\textbf{a) The financial and operating results of the company}

Financial statements that have been certified by an auditor as showing a true position of the financial situation in the company are the most common information about companies. It enables institutionalization of appropriate mechanisms for regular monitoring which is important in valuing of securities. Transparency in financial reporting is important as it assists investors, creditors, and others to scrutinize the financial condition of an entity and make informed decisions. In addition, it increases market confidence.

Some companies may inhibit transparency by using the usual accounting rules in different ways, for example, by using the accounting rules to make the company’s level of debt vague.\textsuperscript{220} If the debts are hidden, the investors cannot estimate their exposure to insolvency risk. A study seeking to find out whether disclosure affects performance of companies listed in NSE revealed that disclosure was crucial in explaining the market value of NSE listed companies.\textsuperscript{221}

The Code provides for disclosure of the review by management of the elements that affect the financial condition and operations of an organisation.\textsuperscript{222} It also provides for disclosure on companies’ compliance with International standards in preparing the financial statements. The Code restates the position contained in the 2002 corporate governance guidelines albeit in a more organized manner.\textsuperscript{223}

\textsuperscript{219} Material information is defined to mean any information that may affect the price of an issuer’s securities or influence investment decisions and includes information on a merger or acquisition, a change in control or significant change in management, significant new product or discovery, purchase or sale of a significant asset, significant labor dispute or lawsuit against the issuer, significant alteration of the memorandum and articles of association of the issuer among others.


\textsuperscript{222} Lisiolo Lishenga1 and Acquiline Mbaka; The link between compliance with corporate governance disclosure code and performance for Kenyan firms, Net Journal of Business Management Vol. 3(1), pp. 13-26, February 2015 ISSN: 2437-1335

\textsuperscript{223} Whereas in the 2002 corporate governance guidelines, requirements on transparency and disclosure were provided for in several distinct principles, the Code has a full chapter on transparency and disclosure.
Publication of financial reports by listed companies is not an issue in Kenya as most of the listed companies comply with the requirement for publication of financial results. The key issue is whether the published financial reports reflect the true financial status of the company. Concerns have been raised on misrepresentations contained in financial statements of some companies.\textsuperscript{224} It is important that companies disclose comprehensive and reliable information on their financial condition and performance.\textsuperscript{225} The regulator should ensure that even as the requirement on disclosure of audit financial statements is complied with, the disclosures made are reliable and show the true status of the financial position of the company to which they relate.

\textit{b) Non-financial information}

Companies are required to disclose policies and performance relating to non-financial information including how they do business, protect the environment, among others. The Code provides for disclosure of the code of ethics.\textsuperscript{226} Companies are also required to disclose the values and strategic objectives in the annual report.

It is important for listed companies to publish their codes of conduct and ethics to enable shareholders understand what they stand for. Publication will also assist in determining whether an organization’s actual conduct is in line with the published code of conduct and ethics.

\textsuperscript{224} Forensic audit conducted on Uchumi in 2015 revealed incidents of possible misstatements in the audited financial statements for financial years 2010 to 2014 published to the investing public for purposes of making investment decision and CMA, while conducting independent investigation summoned the auditors to show cause why action should not be taken against them. See \textit{Ernst & Young LLP v Capital Markets Authority & another} [2017] eKLR/. See also George Ngigi, ‘Imperial Bank Owners mulling action on external auditors’, Business Daily, January 13, 2016. It was reported that Imperial Bank shareholders were contemplating suing the auditors of the companies for failing in their duty to audit the company as per the audit standards and failing to unearth a fraud perpetrated by the company CEO for a long period of time. In Chase Bank, many institutional investors had invested in corporate bonds issued by Chase Bank and Imperial Bank on the basis of the strong financial performance depicted in the financial reports issued by the companies. In Robert N. Gathaiya, \textit{Analysis of Issues Affecting Collapsed Banks in Kenya from Year 2015 to 2016}, International Journal of Management & Business Studies, Vol. 7, Issue 3, Sep 2017, 9-15, he analyses the issues affecting Dubai, Imperial and Chase Banks. He notes that Chase bank underreported its non-performing loans and had fishy special purpose vehicle accounts which siphoned billions of money from the bank. The Bank restated its financial results for year 2015 revealing that it had under-reported the insider loans by Kshs.8 billion. The restated financial results published showed that insider loans money advanced to directors, shareholders, associates and employees of the bank stood at Kshs.13.62 billion.

\textsuperscript{225} Supra note 208 p. 74

\textsuperscript{226} Supra note 175 Principle 7.1 Guideline (e)
Disclosure of non-financial information is a new requirement under the Code.\textsuperscript{227} This is in realization that such information is important for stakeholders to review the operations of the company and how it interacts with the communities situated in areas of operation of the company.

c) Corporate Governance Structures and Policies

The 2002 Corporate governance guidelines only required disclosure in the annual report of all directors over seventy years of age and whether one third of the board comprised independent and non-executive directors.

This requirement has been enhanced in the Corporate Governance Code to require disclosure of additional information, including the size and structure of the board, and board committees and their terms of reference.\textsuperscript{228} Names and qualifications of directors as well as other board memberships should also be disclosed.

Investors need information on board members to be able to assess their qualifications and suitability and assess any potential conflicts of interests they may have that could affect their objectivity. Disclosure is an important element in capital markets, because companies require capital from investors and investors need information on the companies in order to make informed decisions.\textsuperscript{229}

3.3 Conclusion

As earlier noted, there are positive developments in Kenya with the enactment of the new Companies Act and issuance of the new Code of Corporate Governance. The Code contains far-reaching provisions and could greatly improve the corporate governance practices in Kenya if it is fully implemented. There are however a number of inadequacies in the law which have to be addressed.

\textsuperscript{227} The requirement for disclosure of policies relating to non-financial information was not included in the 2002 guidelines.

\textsuperscript{228} Supra note 226 Guideline (m)

The role of non-executive directors is not defined in the Code. It is only presumed that independent directors are meant to provide checks and balances to the management of the company. However, this role may not be effectively carried out since independent directors do not deal with the daily operations of the company. The directors depend on the CEO to provide relevant and complete information, which may not always be given. The resulting information asymmetry may hinder the ability of non-executive directors to effectively perform their monitoring duties.\(^\text{230}\)

The Code emphasizes on the need for recognition and enforcement of the rights of shareholders. The main challenge though, is that shareholders in Kenya are not that sophisticated in terms of appreciating the need to attend annual general meetings and exercising their rights as shareholders of the company.\(^\text{231}\) They cannot also analyse independently the reports submitted by the Board of Directors regarding key issues affecting the company. The code could do more by requiring experts to explain to shareholders the meaning and implication of certain statements and figures upon release of the said reports.

It is noteworthy that the Companies Act has also introduced several changes, including; providing for one member companies\(^\text{232}\); unrestricted objects, unless the Articles expressly restrict the objects,\(^\text{233}\) easier shareholder communication through email or companies’ website, share buy-back\(^\text{234}\) as well as codification of directors’ duties, among others. The Act has improved the ease of doing business in Kenya and will no doubt continue elevating Kenya’s competitiveness across the continent. However, this requires effective institutions and human capital. There is need to

\(^{230}\) Directors of Imperial Bank Limited alleged that the Bank’s management failed to disclose to the Board, the irregular disbursements of funds initiated by the Bank’s Group Managing Director, the late Abdulmalek Janmohamed until the death of Mr. Janmohamed when they opened up to the Board.

\(^{231}\) It is argued that majority of individual shareholders in Kenya are under-informed about their rights as shareholders and may not be have much to complain about. In Edwin Okoth ‘During AGMs shareholders are reduced to spectators’; The Standard Tuesday, June 21 2006, It is argued that many shareholders in Kenya do not take AGMs seriously and despite the fact that important decisions are approved regarding the various development agendas at the AGMs, most of the attendants’ rubber stamp what they have little or no knowledge about.

\(^{232}\) Companies Act, No. 17 of 2015, Sec.102.

\(^{233}\) Ibid Sec. 28. The repealed Companies Act provided that a company is only allowed to do the objects which are set out in its memorandum of association, otherwise such objects would be ultravires. This led to a situation where the memorandum of association of companies ran into several pages with the aim of including all conceivable objects.

\(^{234}\) Supra note 232, Sec. 424. This permits companies to buy-back or repurchase their own shares. For public companies, share buy backs are only allowed if extensive procedures for approval and terms are followed.
ensure that institutions charged with implementation of the new Companies Act are effective so that the benefits of the new Act can begin to be seen.
CHAPTER 4

EFFECTIVENESS OF THE CODE OF CORPORATE GOVERNANCE FOR ISSUERS
OF SECURITIES, 2015

4.1 Introduction

This chapter aims at analyzing the viability of the Code of Corporate Governance for Issuers of Securities by examining whether the Code is alive to the flaws that were exhibited before. The analysis will follow a clear examination of the flaws that have repetitively bedeviled many corporate organisations, with Uchumi Supermarkets Limited (Uchumi) as the case study. The analysis will factor in the changes in the corporate structure and nature of operations of the Company, pre and post publication of the code and all the enabling provisions on Corporate Governance.

4.2 Does the Code adequately address issues of Corporate Governance exhibited prior to 2015?

The Code has provisions in relation to the core shortfalls that faced Uchumi and other companies by extension. In this section, this thesis will address the aspects of conflict of interest; Misrepresentation of financial accounts and Transparency and accountability. We will probe the adequacy and efficacy of these provisions in relation to the best practices as well as the prevailing industry requirements.

4.2.1 Conflict of Interest

The Code makes precise provisions as regards conflict of interest in a company.\(^{235}\) The Code requires Directors to come up with a conflict of interest policy.\(^{236}\) The Code further requires

\(^{235}\)The Code defines conflict of interest as “a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person’s self- interest and professional interest or public interest”.

\(^{236}\)Supra note 175 Recommendation 2.38
Directors upon joining the Board to declare and give a disclosure of both actual and perceived conflict of interest with the company.\textsuperscript{237}

The Code further provides that Independent Directors are supposed to bring independent and objective judgment on the table and the Board should determine who the Independent Directors shall be on an annual basis.\textsuperscript{238} The conflict of interest policy should be disclosed to the public as part of its conforming to the principles of disclosure.\textsuperscript{239}

Conflict of interest has been singled out as one reason that contributed to the collapse of Uchumi Supermarkets in 2015.\textsuperscript{240} In CMC Holdings, the Board awarded a logistics contract to Andy Forwarders which was owned by Mr. Muthoka at a time when Mr. Muthoka was the acting Board Chairman. This demonstrates that the tenets of good governance are routinely sacrificed at the altar of personal aggrandizement.\textsuperscript{241} Although members of the Board were aware that Mr. Muthoka was a vendor of the company but it nevertheless made him the Chairman. This constitutes conflict of interest under the Companies Act, 2015. It is inequitable for a controlling majority shareholder to expropriate company resources.

Because the Companies Act, 2015 codifies directors’ duties, which derive from the no conflict principle, it is expected that going forward, any breach by directors on the no conflict principle will be seriously dealt with to ensure protection of shareholders.

\textsuperscript{237} Ibid
\textsuperscript{238} Supra note 175 Recommendation 2.41. The guidelines further prohibit Directors from taking part in any discussions and decision-making in relation to matters to which they have a conflict of interest with the company. Companies are required to keep a register of conflict of interests declared.
\textsuperscript{239} Supra note 175 Recommendation 7.1.1
\textsuperscript{240} The former Managing Director of Uchumi Supermarkets Dr. Jonathan Ciano was found not to have disclosed his conflict of interest involving Uchumi’s business partners and a financial penalty of Kshs5 million was levied on him by the CMA Board. It also disgorged from him Kshs13.5 million being deemed profits obtained due to non-disclosure of the conflict of interest. Dr. Ciano’s wife was the major supplier of fresh produce to the retailer’s outlets and was always paid before other suppliers.
\textsuperscript{241} Africa Centre for Open Governance, ‘Kenya Governance Report 2011’, Note 112
4.2.1.1 Inadequacies of the Legal Framework on Conflict of Interest

4.2.1.1.1 Non-Executive Directors

Despite there being a concise legal framework on the concept of conflict of interests; this paper posits that there are glaring inadequacies in the laws, regulations and guidelines on conflict of interests. For instance, the role of non-executive directors was not given the significance it deserves in terms of diffusing perceptions of conflict of interest. The current provisions do not precisely give powers to non-executive directors to make decisions in matters where conflict of interest is perceived or manifest among executive directors. Such decisions may relate to the personal welfare of executive directors for instance the remuneration of directors or the privileges of directors.

The position of non-executive directors would have been served best if they were to be given a more supervisory authority in the company by receiving periodical updates, reports and information from management. Since the management of a company is the one which has a direct interaction with the financial information, there should be a direct link in terms of reporting between the management and the audit committee. This is to cure the mischief that management may only disclose information it wishes to disclose to the committee. As such, to avert any form of misrepresentation, it would be prudent to have all the financial and business information accessed by management to be handed over to the audit committee and other relevant committees for further, analysis, interrogation and action.

4.2.1.1.2 Independent Directors

The Code provides for a definition of an independent director. Essentially, an Independent director is supposed to be impartial, professional and highly objective. The member must be honest and be able to completely assess the situation and make an informed decision. An independent

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242 The EU Commission’s position as to the role of non-executive or supervisory directors in its Action Plan1 adopted on 21 May 2003. European Commission, Internal Market Directorate General, Brussels, 5 May 2004, Recommendation on the role of (independent), non-executive or supervisory directors, Consultation document of the Services of the Internal Market Directorate General

243 The Code provides that an Independent Director is one who is “a member of a board of directors who does not have a material or pecuniary relationship with the company or related persons, is compensated through sitting fees or allowances, does not own shares in the company and after nine years of service, a continuing independent director ceases to be one and assumes the position of a non-executive director”.

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director should not have business relationship or personal connection with the management of the company.

The Code requires that the Board of Directors be composed of both executive and non-executive directors and that independent non-executive directors should be at least one third of the total composition of the Board. With independent non-executive directors being the only members that can be substantially relied on in terms of impartiality and making decisions from a professional point of view without any vested interests it would be proper to have a majority or at least half of the composition of the Board of Directors to enhance independence in decision making.

4.2.1.1.3 Benefits to and from Third Parties

At the heart of any conflict of interest is the perception or anticipation that when a Director of decision-maker compromises their independence, they will receive a benefit from a third party or they will appease a third party who already conferred a benefit upon them. Yet there is no single provision in the Code which purports to specifically bar Directors of a company from demanding from, receiving from or conferring benefits to third parties. In an era in which corruption is an endemic scourge that breathes in almost every institution, such a provision should be precisely pronounced not only as a prescriptive provision, but also as a forewarning to directors of companies about the malpractice.

The Uchumi Supermarkets scandal; especially the Aga Khan Walk branch office premises transaction provokes the probable imagination that for the Directors to sell the property for Kshs. 147 Million and then lease it back immediately for Kshs. 1.7 Million per month, must have been induced by a benefit received by one of the decision-makers or directors. That is the more reason why prohibition of benefits conferred to directors especially if the third party has an interest in dealing with the company has to be spelt out clearly. Left uncensored, Directors will see no harm in pursuing personal interests as at the expense of interests of the company.

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244 Supra note 175 Recommendation 2.1.3
4.2.1.4 Competing against the Company

The legal regime on conflict of interest is equally silent on the concept of directors engaging in a business or a trade that is directly in competition with the company’s business. A director, who knows the intricacies of the company including its financial standing, business strategy, competitive and comparative advantage should not be allowed to be engaged in a business which is in the same industry as the company he or she directs. They should not carry out business on their own accounts or on accounts of others if the business offers direct competition to the Company. They should not equally be allowed to share in the proceeds of the business that is in competition with the company they direct.

4.2.1.5 Related Party Transactions

The Code requires the Board to develop a policy to deal with transactions between an entity and other parties that have pre-existing business relationship or common interest. The other requirement imposed on this front is that all related party transactions should conform to the law and be approved by the board. The Code stops there. It does not require that the transactions to be approved should have been done in order to support the strategic objectives of the company. Further, it fails to reduce in detail the process of approval of such a transaction and the Directors/shareholders that should participate in the approval.

4.2.2 Misrepresentation of Financial Statements

The Code prescribes that corporations should embrace integrated reporting which is defined as reporting that brings together all aspects of the company including organization strategy, governance and management; reporting that demonstrates the organisation’s stewardship and reporting that combines the most of material information including financial, management, governance and sustainability.

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245 A related party transaction is defined as a business deal or arrangement between two or more parties who are joined by a special relationship prior to the deal and includes, a business transaction between a major shareholder, or any company in which he holds shareholding, and the company;
The Code mandates the audit committee to review the financial reports. Further, the Code emphasizes on the competence and impartiality of the company’s external auditors. The guidelines under this limb indicate that the Board should ensure timely preparation and release of the financial reports.

The Code requires the Board explain its role in the preparation of the annual report. The external auditor should also issue a statement about their reporting responsibilities. This provision further imposes a burden on the Board by stipulating that the Board be responsible for ensuring that the financial statements are accurate.

The shareholders are empowered to appoint external auditors in every annual general meeting. The Board is required to recommend a change or rotation of external auditors within 6 to 9 years. They can do this by making a recommendation to the shareholders during the annual general meeting. The Board is also expected to facilitate introduction of integrated reporting whose main purpose is to enhance disclosure of salient issues affecting the Company.

4.2.2.1 Inadequacies of the Legal Framework on financial reporting

Directors are required to prepare the company’s financial statements. They may also approve financial statements even if they did not prepare them by themselves so long as they are convinced that it portrays an accurate picture of the company’s financial status.

Many companies exploit the accounting rules with a view of compromising transparency by for instance issuing vague statements on the company’s debt. The Code provides that the audit committee’s responsibility is to review the financial statements to confirm they are prepared in line with the International standards. However, the Code does not have sanctions for directors and management who knowingly give misleading and blurred financial statements. In as much as the

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246 Supra note 175 Recommendation 6.1.1.
247 External Auditors are required to confirm that the financial report meets the applicable financial reporting standards and that the report is reliable.
248 Supra note 175 Recommendation 6.1.2. Under the Code, the Directors have an obligation to ensure that a professional relationship is maintained with the external auditors and that a form of independence is equally manifested.
249 Supra note 175 Recommendation 6.1.4.
250 Section 635 of the Companies Act provides that directors shall prepare and issue financial statements, failure to which, they are liable for an offence
251 Sec 636 of Companies Act.
Code provides for companies’ compliance with the international standards in preparing the financial statements, there are no specific sanctions attached to failure to conform to these provisions.

The regulator should ensure that even as the requirement on disclosure of audit financial statements is complied with, the disclosures made are reliable and show the true financial status of the respective company. Much as the legal regime on corporate governance insists on disclosure in terms of financial reporting, there is no strict obligation on the Chief Finance Officer and the Managing Director to give an accurate report. It is only when accurate information and reports are published, that a rights issue by the Corporation can be evaluated by investors and make a rational and well informed decision thereof.

4.2.3 Breach of prescribed rules of procedure and operations

The responsibility for enforcement of the Code lies squarely on the shoulders of the Capital Markets Authority. The Code adopts the “Apply or Explain” model of enforcement which requires Companies to abide by the provisions of the code and if not, explain why they are not able to abide. As such, the enforcement mechanism is difficult and would rarely yield results since Companies do not feel the instant obligation to comply. In the end, the model exposes the stakeholders of the corporation to unnecessary risk and abuse by unscrupulous Boards of Companies. The legal framework on corporate governance does not stipulate the precise sanctions to be meted to a company that is not compliant.

4.3 Protection of the Rights of Shareholders

Most of the stop gap measures in the Code are majorly hinged on the participation of shareholders especially in appointment of Directors and in ratifying key decisions of the Board. The challenge is that majorly, minority shareholders in Kenya rarely take part in the annual general meetings (AGMs). Despite the fact that important decisions are approved regarding the various development agendas at the AGMs, most of the attendants’ rubber-stamp what they have little or no knowledge

252 “Comply or explain” <http://www.corporategovernanceboard.se/the-code/comply-or-explain>
about. Many retail shareholders do not engage or challenge the boards as the expectation of many is higher dividend payouts and branded freebies.\textsuperscript{253}

The investors do not view themselves as the owners of the company to whom the board should be answerable. This is due to the low financial literacy and fear of authority.\textsuperscript{254} As such, there is need for capacity building on both directors and shareholders to comprehend what their roles and responsibilities are as relates to management and oversight of the corporation.

Given that most shareholders are less interested in the affairs of the company they have invested in; it is very hard for them to exercise their oversight mandate over the Board of Directors. Although management policies of a company are made by the board, shareholder’s decision making is crucial in the governance of companies. The Capital Markets Authority should endeavor to carry out public awareness sessions to the public who are the minority shareholders in many of these Corporations on their duties, rights and financial literacy with a view of making them able to read and understand the financial reports and know what questions/information to seek in reviewing performance of the board of directors.

Since shareholders can only effectively carry out their mandate having gone through the annual reports and accounts presented to them at the annual general meetings, it has also been difficult to actualize this task since the shareholders have a difficult time in interpreting and understanding the financial statements, reports and any other documents indicating the strategic plan and direction of the Corporation. These documents are in most cases drafted in a manner that does not afford the ordinary shareholders an opportunity to interpret them and make an informed decision thereof. That explains the reason as to why many shareholders just rubber stamp decisions which they have little or no knowledge about at the annual general meetings.\textsuperscript{255}

\textsuperscript{253} Supra note 206
\textsuperscript{254} Steven Orengo, “In Kenya, bad ethics is good business until you get caught”, 4th May 2016, Nairobi Business Monthly available at \url{http://www.nairobibusinessmonthly.com/in-kenya-bad-ethics-is-good-business-until-you-get-caught/} accessed 4\textsuperscript{th} July 2018
\textsuperscript{255} Supra note 206
4.4 A Brief Background of Uchumi Supermarkets Limited

Uchumi Supermarkets Limited was incorporated in 1976 having started as a chain of retail supermarkets with branches across the country. The initial promoters and subsequent shareholders of the Company were Industrial Commercial & Development Corporation (ICDC), Kenya Wine Agencies Limited (KWAL) and Kenya National Trading Corporation (KNTC); the trio being state corporations. The three parastatals entered into a management contract with an Italian Company by the name StandaSPA which was responsible for managing the chain of supermarkets.256

Uchumi Supermarkets Limited experienced a steady growth and dominance in the market from the time it was incorporated up until the early 2000’s when it started experiencing difficulties. There was poor strategic planning and relatively weak internal control mechanisms leading to inability to manage the rate at which the Company’s business operations were expanding.257

4.4.1 The 2006 Collapse

In 2005, the Company closed 10 of its branches which were perceived to be non-profitable. The Company’s uncensored and inordinate expansion ventures led to reduction of its resources and subsequently continued inability to settle its obligations. Furthermore, the Company bought expensive operational technology which required a lot of money for it to be operational. The expansion and technology adopted caused the Company to borrow excessively to such an extent that by June, 2006, had outstanding liabilities estimated at Kshs. 2.2 billion.

The huge debt led to many stakeholders including prospective lenders and stakeholders to avoid dealing with the Company out of fear of not getting their money back. The large debt led to many stakeholders including prospective lenders and stakeholders to avoid dealing with the Company out of fear of not getting their money back. There were efforts to restructure the Company, which efforts did not bear any fruits. As such, on 31st May 2006, the Board resolved that the company ceases operations. On 2nd June, 2006, Company was placed under receivership and was subsequently suspended from trading on the NSE by CMA.258

257 Ibid
Another factor that led to the decline of Uchumi in 2006 was conflict of interest. Some of the Board members of the Company acted as the major suppliers of merchandise to the Company. In that case, with their conflicted business minds, they skewed decisions so that the Company would engage in trading heavily in the stock they supplied. They also exaggerated the prices to favor their interests. As such, most of the Company’s stock was imported as opposed to locally manufactured. Board Members made decisions that favoured their business interests. For instance, the many branches that were opened were aimed at facilitating real estate transactions in which some of the Board members had a stake in.\(^\text{259}\)

The Ministry of trade was not even informed of the decision of closing down the Company even though the government had a stake in the Company’s shares. The Permanent Secretary then, David Nalo wrote to the CMA and the Anti-Corruption Agency recommending investigations into the closure since according to him, Uchumi Supermarkets Limited was a Public Company by dint of the fact that 26.5% of its shares were owned by KWAL and ICDC.\(^\text{260}\)

A taskforce was formed comprising of the then PS Secretary for Trade, Solicitor General and Investment Secretary. It found out that Uchumi had collapsed due to unplanned and ambitious expansion programme that led to serious cash flow problems. The task force also found out that the Company’s unjustifiable financing model and expensive lease termination options also contributed to the collapse.\(^\text{261}\)

The investigations led to certain prosecutions and further enquiries into the operations of the Company. For instance, the case of Republic Vs Lloyd Masika and Uchumi Supermarkets and 13 others,\(^\text{262}\) in which a section of the board of directors were charged with the offences of conspiracy to defraud the Company and breach of public trust. The offences that were preferred against the


\(^{262}\) Republic Vs Lloyd Masika and Uchumi Supermarkets and 13 others Criminal Case No. 900 of 2008
Directors were in relation to the irregular sale of Uchumi Supermarket’s Aga Khan Walk branch building for Kshs. 147 million and then leased to the Company at a monthly rent of Kshs. 1.7 million. In his defence, the former chairman, Chris Kirubi stated that it was necessary for the Company to sell the building in order to inject the money into the business since at that time, it was facing a severe financial crisis. His other line of the defence was that the Company was a corporate legal entity and had the power to acquire and sell the property and lease back premises already sold. He further added that the decision to sell the premises had been supported by management of the Company as well as the government as represented by the Permanent Secretary for Trade.263

The Court found that the Board approved the sale in accordance with the internal procedures of the Company. The Court further held that the Public Procurement and Assets Disposal Act, 2005 and its regulations thereto were not applicable in this case since the 26.6% shareholding by Public Companies was not sufficient to make it a State Corporation. This is the same reason that absolved the Board of the offence of breach of public trust. Further, the prosecution did not invoke the provisions of the 2002 Guidelines on corporate governance practices because it did not have any force of law and its contravention would not attract any civil or criminal sanctions.

4.4.2 The 2016 Collapse

The downfall of the Company was followed by a decision to resuscitate it which decision was actualized by the appointment of a new Board of Directors and management led by CEO, Dr. Jonathan Ciano. A sum of Kshs. 675 million was also injected in the Company by the government and an additional Kshs. 300 million raised from shareholders helped in boosting the company significantly. There was a well strategized campaign for marketing and painting the Company in good public light with a view of restoring public confidence in the chain.

263 Rob Jillo “Kirubi, 13 others acquitted in Uchumi”
The Company started operating and some profits were realized once again. Owing to this growth, the company sought CMA approval to relist its shares on the NSE. This application was later granted and the Company started trading at the NSE on 31st May, 2011.

The Company continued performing dismally in subsequent years and in the year 2014, it could not pay dividends to its shareholders. The financial situation of the Company was henceforth aggravated by managerial flaws and failure to observe corporate governance practices.

In November 2016, CMA Board took enforcement actions on former Uchumi CEO, CFO and directors, among others for breaches that were confirmed after CMA carried out an investigation. Below are some breaches that led to the downfall of Uchumi.

4.4.2.1. Conflict of Interest

The management of Uchumi became the major suppliers of the Company. There were instances where products to be purchased by the Company were overpriced to an extent that the buying price would be even higher than the selling price. Amidst the scheme to trade with the Company were members of the top management of the Company. The CEO, Dr. Jonathan Ciano was equally implicated in view of his wife’s dealings with the Company as the chief supplier of fresh produce. Following the CMA inquiry, Dr. Ciano was found not to have declared his conflict. Among other penalties imposed by CMA on Dr. Ciano was disgorgement from him of Kshs13.5 million which were taken to be the profits made out of the undisclosed conflict of interest.

These actions were in outright violation of Section 146 of the Companies Act, 2015 which imposes a duty on Directors to avoid conflict of interest. According to common law and equitable principles, a director has to avoid every situation that could be imputed to cause either a direct or indirect conflict of interest with the company. In addition to this, this was a clear case of use and

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266 As revealed by the forensic audit conducted by KPMG.
267 Supra note 265
268 Supra note 250 Sec. 146
misuse of information only known to the CEO because of his position of privilege in the Company.\textsuperscript{269}

4.4.2.2 Misrepresentation of Financial Accounts

The management of Uchumi Supermarkets Limited was also accused of issuing fraudulent books of account as well as prospectuses. Following the inquiry by the CMA Board, it was established that sale and lease back transaction was recognized in the financial statements for the period ended June 30, 2014, before the funds were actually received in September 2014 thereby inflating the profits.\textsuperscript{270} In addition, the liabilities were understated by about Kshs. 1 billion. This treatment was reversed in the audited accounts in 2015, with the Board stating that the recognition of the asset sale and leaseback had been premature.

The inquiry further established that land was unsuitably stated to be an investment property in the financials in spite of the fact there were caveats prohibiting the sale of the land and litigation cases pending in court disputing its ownership. Information on these caveats and litigation cases were not disclosed in the financial statements and they were not considered when valuing the property thereby misleading the public on the profitability of Uchumi.

4.4.2.3 Failing to disclose material information

Disclosure of material information to investors is crucial to help them in decision making. Uchumi had planned a rights issue which proceeded in 2014. In 2012, management proposed to the Board a recapitalization of the Company through a rights issue. The Board approved the recommendation for the proposed rights issue of up to 100 million shares for recommending to the shareholders which was approved in 2012. The rights issue actually proceeded in 2014 and Kshs. 895 million was raised.

The inquiry made by CMA established that the information Memorandum that was published had not been updated with the material developments that had occurred in Uchumi which ought to have been disclosed in order to give investors an updated position of the company. These included

\textsuperscript{269} This is equally an offence under Section 151(10) of the Companies Act, 2015 punishable with a fine of up to one million shillings. A director must always disclose the possibility of there being conflict of interest in relation to any of the operations of the company.

\textsuperscript{270} Supra Note 265
changes in business strategy relating to branch expansion activities, draw-down of loans from banks as well as asset sale and leaseback transaction in order to address liquidity.

4.4.2.4 Misapplication of Rights Issue proceeds

The purpose of the funds as communicated to the public was to fund the opening of 13 branches in Kenya, Uganda, Rwanda and refurbish the existing ones. Following the inquiry, it was established that out of the Kshs. 895 million right issue proceeds received by Uchumi in January 2015, a small portion of the funds was used to pay expenses relating to the rights issue. However, the rest of the funds were transferred to the trading account and used to settle debts as opposed to fund the expansion of branches. The mixing of the proceeds of the rights issue proceeds with the funds generated from trading made it difficult for the actual application of the rights issue proceeds to be tracked.

4.4.2.5 Weaknesses in board oversight

The CMA inquiry found out that branch expansion was done haphazardly without proper planning. The risks were not considered and mitigating actions put in place. It was also noted that in some instances, Uchumi made pre-payments for rent but the branches were never opened and the funds were not recovered. The Board failed in its oversight role as it did not raise any queries.

It was further observed that assets worth Kshs. 1.1 billion were apparently sold. Although the Board denied approving the transaction, the company received Kshs. 613 million from the transaction.

4.5 Conclusion

As earlier noted, there are positive developments with the enactment of the Companies Act and publication of the Code of Corporate Governance. The Code contains far-reaching provisions and could greatly improve the corporate governance practices in Kenya if fully implemented.

However, there are still challenges that need to be addressed; and these include the need for enforcement of the Code and the Law to ensure that it is implemented; the need for capacity building and awareness creation, especially on shareholders to understand their rights and

271 Supra note 265
obligations and on directors as well to understand their responsibilities under the new regime; need for provision of diversity in boards, etc. We shall review these further in the next chapter.
CHAPTER 5
CONCLUSION AND RECOMMENDATIONS

5.1 Summary

This study sought to analyse the Code and the whole legal regime on corporate governance while evaluating the extent to which the legal instruments address the corporate governance challenges facing listed companies in Kenya. A number of inadequacies of the legal framework governing have been pointed out in the previous chapter and the focus now shifts to suggesting the possible solutions or areas of improvement towards achieving a robust corporate governance structure in the country. I will also make recommendations needed in order to promote the best governance practices in Kenya.

It has been established in this paper that even with the significant changes in the corporate governance legal regime, there are some challenges and gaps that are still rife and ought to be addressed promptly to avert any further corporate collapses and to secure the interests of investors. A summary of these challenges as discussed here above is that there is a very weak enforcement mechanism of most of the recommendations found in the Code. Save for the directors duties codified in the Companies Act, 2015 which attract criminal sanctions, many of the obligations borne by the Board of Directors under the Code cannot be enforced.

Secondly, having established that shareholders play a crucial role in terms of oversight of decisions made by the Board, it is unfortunate that they cannot fully partake in this exercise because of a number of reasons including lack of the requisite financial knowledge and advice in relation to the financial position of the companies.

The role of independent directors is also not spelled out clearly. Therefore, it is not clear even to those directors what specific role they ought to play, especially considering that there is information asymmetry between the independent directors who do not deal with daily operations of the company and the executive directors who are responsible for the daily operations of the companies.
5.2 Recommendations

Under this segment, the following proposals are aimed at strengthening the current legal regime on Corporate Governance and sealing the seeming flaws of the framework.

5.2.1 Enforcement

Recent research supports the view that the main difference between developing economies and developed ones lie in the enforcement of the law.\footnote{272 Erik Berglof & Stijn Claessens, Enforcement and Corporate Governance, Discussion paper 5, The Global Corporate Governance Forum available at http://documents.worldbank.org/curated/en/947321468162281108/pdf/357090DP151CG11erglof1200301PUBLIC1.pdf} Enforcement of the laws is the primary problem in Kenya.\footnote{273 Global Corruption Report 2009, The corporate governance crisis in Kenya’s financial sector available at http://tikenya.org/wp-content/uploads/2017/06/adili113.pdf accessed on 4th July 2018.} It is important to address the ability of the various authorities responsible for enforcing the law. There is in terms of human resource capacity, proper systems to monitor compliance, the requisite skills and knowledge required, etc. It is also important to strengthen the incentives for companies implanting the Code to enhance adoption of good governance practices.

The roles of various regulators are delineated but there are some areas of overlap and lack of framework for coordination where such overlaps exist. The primary regulator for banks and financial institutions is the Central Bank of Kenya but where a bank intends to issue a security to the public, they seek approval from CMA. In such cases, there is need for the two regulators to agree on a framework of co-ordination. It is therefore important for the different regulators to agree on a framework for co-ordination and sharing of information to help in decision making.

The merits of the ‘apply or explain’ approach include flexibility in compliance since one set of rules may not necessarily fit all the companies. It can also be concluded that a company that deviates from a code and explains itself is well-managed. The explanations given also empower shareholders to assess whether or not the deviation was justified.

However, these explanations are not structured. They may be subjective, given just as a matter of course and not substantiated, and may not be easy to verify. Corporations are also not required to take alternative measures that will uphold the intent of the provision they are deviating from. Since
regulators do not publicise non-compliance, it is not easy to tell whether the “apply or explain” approach is effective. It follows that since there are no sanctions, there isn’t a record of deviations for reference purposes. As such, non-compliance by corporations should not only be documented, it has to be shared amongst the shareholders.

There should be specific sanctions imposed on Issuers of Securities in the event there is any breach of the Code of Corporate Governance.274 It is important to discuss directors duties and at the same time discuss the corresponding liabilities duties and liabilities go hand in hand.275

In that case, this paper proposes that the Code should be spell out the applicable sanctions against directors of Companies should they fail to carry out a duty imposed by the regulations and without giving sufficient explanation for the failure to carry out their duties. The directors and Board members should be held culpable individually with a view of deterring laxity when it comes to the breach of their fiduciary duties.

5.2.2 Shareholder Activism

The Code has extensive provisions on the rights of shareholders, including to receive information about the performance and seek clarification, right to attend and participate in the annual general meeting of the company among others.

As earlier observed, shareholders in Kenya do not take the annual general meetings (AGMs) seriously. Even those who attend such forums act are not apprised of the issues to be discussed and the relevant information surrounding the said issues. Investors do not view themselves as the owners of the company to whom directors are answerable due to the low level of financial literacy and fear of authority.276

274 Sadri asserts that “the role of corporate governance is to ensure that the directors of a company are subject to their duties, obligations and responsibilities, to act in the best interest of their company, to give direction and to remain accountable to their shareholders and other beneficiaries for their actions” See Sadri Jayashree, “Some Views on Corporate Governance” (Indira Management Review 2006) http://www.indiannmba.com/Faculty_Column/FC282/fc282.html accessed 15 September 2013.
Good corporate governance practices are premised on the shareholders monitoring the actions of directors and it is important for shareholders to perform this role. It is possible that most of the shareholders are unaware of their rights and there’s need for public awareness of the rights of shareholders to understand their rights and obligations as this would lead to better corporate governance practices in these companies.

Therefore, this paper recommends that the Capital Markets Authority puts in place shareholder awareness programmes with a view of sensitizing the shareholders about their rights and the specific financial aspects that they should be keen to interrogate once the financial statements are presented to them.

The Companies Act has codified the common-law based derivative action. It has also expanded the range of circumstances in which a derivative action can be maintained thus making it easier for shareholders to hold the directors of the company to account for their actions. Much as the provision on derivative action has opened a window for minority shareholders to institute suits against majority directors for mismanagement of Company resources; the current legal regime is not clear on whether leave to file the suit as a derivative action has to be sought first before filing the suit; or whether the suit can be filed contemporaneously with the application for leave. This is a question that has been dropped at the doorstep of each Court whenever a derivative action has been filed. Nonetheless, it would be better to have the precise procedure for filing derivative suits spelled out. It is expected that the number of derivative actions lodged may increase.

5.2.3 The Audit Committee & Financial Reporting

The Companies Act requires listed companies to constitute an audit committee of the board appointed by the shareholders. The mandatory requirement for an audit committee to be appointed by shareholders is good but a lot should be done to ensure that the value of the audit committee to the performance and good governance of listed companies is realized. One major challenge as highlighted in the previous Chapter is information asymmetry between the members of the audit committee who are required to be independent directors who are not concerned with the daily

277 An example is the case of Amin Akberali Manji & 2 others v Altaf Abdulrasul Dadani & another, 2015 KLR, where the Court held that filing of the suit and the application contemporaneously was within law.
operations of the company and management who are privy to all information about the company. Management may opt to provide the audit committee with insufficient information which does not reveal the actual position of the company, leading to an audit committee report that does not factor in all the possible facets of the organization’s financial status.

This paper recommends that a clear sanction be imposed on failure by management to submit the correct financial statements to the audit committee. This way, possible financial challenges in the running of the Company will be detected at the earliest and remedial measures can be taken in a timely manner.

There is also need for capacity building on directors to understand their responsibilities as stipulated by the new legal framework. The Center for Corporate Governance has been at the center of training of directors. The recommendation is for a requirement that for one to be appointed as a director of a corporation, they have to have evidence from the Center of Corporate Governance that they have the basic training.

The legal framework should also limit potential conflicts of interests involving external auditors. Many auditors provide services outside audit businesses they serve. The Code requires that the Board should put in place the necessary controls that promote the independence together with competency of auditors engaged to conduct external audit. It is however silent on the issue of provision of other additional services by these auditors which do not fall within audit. Reform should seek to limit the potential conflicts of interests by restricting the extent of services that can be provided by external auditors to strictly audit.

The Capital Markets Authority should strengthen its oversight of company reporting as it has statutory authority over listed companies and those that issue securities to the public. This will ensure that the information disclosed is credible and can be relied on by the public.

5.2.4 Roles of Non-Executive and Independent Directors

The Board should comprise a balanced blend of the executive together with directors not having executive privileges and those who are independent with no executive privileges. Independent non-executive directors ought to hold no ties or relationship in any way with the persons charged
with the management function of an organization because they are required to act as trustees safeguarding the interests of shareholders. They are therefore required to have full information which enables them to critique undesired trends on business issues in the organization.

While the Code defines who an independent and non-executive directors are, no common definition has been advanced in terms of their roles and tasks and responsibilities of directors without executive privileges. Past case studies show that there is value in clarifying the role of independent non-executive directors.278 In view of this, it is important to clearly define the different roles of directors with executive powers as well as the roles of directors deemed independent together with those who re director with no executive powers. This will guide the shareholders in assessing how well each of these directors has performed in their differentiated roles.

As such, we propose that directors with no executive powers together with those that are independent be given a supervisory/monitoring role over the directors with executive powers in the company. This will be more effective than having shareholders who do not have intricate information and knowledge about the daily operations of the company exercise oversight over the performance of the board.

278 Supra note 188. A study conducted on UK listed companies to investigate whether non-executive directors play a role in determining firm performance, showed that the presence of non-executive directors on the board exerts a positive role on the corporate value.
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