THE TREATMENT OF FAMILY OWNED COMPANIES BY THE EXISTING CORPORATE GOVERNANCE FRAMEWORK IN KENYA: A CASE FOR REVIEW

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G62/8006/2017

A Research Project submitted in partial fulfilment of the requirements for the award of the Degree of Masters of Laws Degree of the University of Nairobi Law School

October 2019

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DECLARATION

I, CYNTHIA KAGIRI, declare that this is my own original work and that it has not been presented and will not be presented to any other university for similar or any other degree award.

Signature _________________________________ Date ________________________________

CYNTHIA KAGIRI

G62/8006/2017

This project has been presented for examination with my authority as a university supervisor.

DR. NJARAMBA GICHUKI

Signature _________________________________ Date ________________________________

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DEDICATION

To my family, one of God’s greatest gifts to me.

And especially to Mr. and Mrs. Samson Mugo, who left me an indescribable legacy and encouraged me to pursue my dreams for God’s glory.
ACKNOWLEDGEMENTS

I would like to acknowledge the Almighty God for carrying me through. This work is a testimony of His grace and providence.

This project would not have been possible without the humanitarianism of Professor Arthur Eshiwani and the support of my official supervisor, Dr. Njaramba Gichuki. Thank you for your guidance, and on occasion, tolerance.

I also acknowledge the invaluable support of my colleagues who asked questions, held me accountable and even proof read this work (and left it with the ominous tracked changes): Victorine Rotich, Julie Mwangi, David Wanjoji and Elizabeth Kamau, I am so grateful.

I am especially grateful for the encouragement and moral support provided by my family, and Christine Ngina, my second mum. Thank you for putting up with me during my academic adventures.
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The Constitution of Kenya, 2010

The Companies Act, 2015 LOK

The Companies Act CAP 486 (Now Repealed) LOK

The Capital Markets Act Cap 485A LOK

The Insurance Act Cap 487 LOK

REGULATIONS

Insurance Regulatory Authority Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011

CMA Code of Corporate Governance Practices for Issuers of Securities to the Public 2015

Central Bank of Kenya Prudential Guidelines on Corporate Governance 2013 CBK/PG/02 Corporate Governance

Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACCA</td>
<td>Association of Chartered Certified Accountants</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<tr>
<td>CMA</td>
<td>Capital Markets Authority</td>
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<tr>
<td>FOC</td>
<td>Family Owned Company</td>
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<td>IBGC</td>
<td>Brazilian Institute of Corporate Governance</td>
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<tr>
<td>ICPAK</td>
<td>Institute of Certified Public Accountants Kenya</td>
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<td>ICS</td>
<td>Institute of Certified Public Secretaries Kenya</td>
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<tr>
<td>IRA</td>
<td>Insurance Regulatory Authority</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>LOK</td>
<td>Laws of Kenya</td>
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<tr>
<td>NSE</td>
<td>Nairobi Securities Exchange</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>PSCGT</td>
<td>Private Sector Corporate Governance Trust</td>
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<td>PSC</td>
<td>Public Service Commission</td>
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<td>RBV</td>
<td>Resource Based View Theory</td>
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<td>SEW</td>
<td>Social Economic Wealth Theory</td>
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<td>SASRA</td>
<td>Sacco Societies Regulatory Authority</td>
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CHAPTER ONE

INTRODUCTION

This study investigates the existing corporate governance framework in Kenya and its influence on the operations and governance of Family Companies\(^1\). It argues that the existing corporate governance framework is insufficient to address the corporate governance challenges faced by Family Companies and enable them to fully exploit their unique competitive advantages. This is an undesirable position because as will be seen by the study, Family Companies form the majority of businesses in the world and Kenya is no exception. In fact, it has been recently reported that the contribution by family businesses to Kenya's gross domestic product (GDP) amounts to 75 percent\(^2\).

The widespread presence of Family Companies is felt in almost every industry in Kenya, with families such as the Ndegwa family in the financial services industry, the Kenyatta Family in the dairy and banking industries, the Karume and Matiba families in hospitality and the Chandaria family in manufacturing\(^3\). No other sector evidences the predominance of Family Companies as much as the retail and supermarket industry which will be the focus of this study. Family Companies are therefore

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1 For purposes of this study, the definition of a Family Company as per the IFC Family Business Governance Handbook shall be adopted and shall refer to a company where the voting majority is in the hands of a controlling family; including the founder(s) who intend to pass the business on to their descendants. The terms “Family Owned Company”, “Family Business”, “Family Company” and “Family-owned Business” will be used interchangeably.
important contributors to the economy, and it is important to ensure that the corporate governance framework enables them not only to exist but to thrive.

After highlighting the insufficiencies of the existing corporate governance framework in Kenya in dealing with matters governance in Family Companies, the study will examine how corporate governance in Family Companies has been approached in other jurisdictions with a view to protect the identity of Family Companies. The final section of this study will suggest some of the measures that need to be taken to adequately regulate and support good corporate governance structures within Kenyan Family Companies.

1.1. Background of the Study

‘Families have always been at the heart of business’ begins a 2015 special report by the Economist\(^4\). This statement is supported by several studies that have shown that family owned enterprises account for 2/3 (two thirds) of all businesses around the world and contribute up to 70% - 90% of global GDP annually\(^5\). The same tendency is reflected in emerging markets\(^6\) where 60% of private-sector companies in these markets with revenues of US$1 billion or more were owned by founders or families in 2010\(^7\).

Similarly, the presence of Family Companies is felt strongly in Kenya. Close to 30% of companies listed on the Nairobi Securities Exchange (NSE) meet the definition of family owned business under

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\(^6\) Argentina, Brazil, China, India, Indonesia, Mexico, Poland, South Africa, South Korea, Turkey, Egypt, Iran, Nigeria, Pakistan, Russia, Saudi Arabia, Taiwan, and Thailand.

the NSE where families or descendants possess twenty-five per cent of the decision-making rights mandated by their share capital. In a 2018 Family Business Survey, PricewaterhouseCoopers reported that family businesses in Kenya are in robust health, with revenues expected to continue growing for the vast majority (82%), compared to 84% globally, with 30% of Kenya respondents saying that growth will be ‘quick’ and ‘aggressive’ compared to 16% globally.

The dominance of family businesses in Kenya can best be illustrated by looking at the retail industry – where the market is dominated by Family Companies. The list of the top 5 major supermarket chains in the Kenyan retail sector boasts at least 4 Family Companies, and it has become increasingly important to examine the application of corporate governance principles and practices in Family Companies in a sector that reported a 13% expansion in 2016. It is also in the retail industry that the corporate governance problems faced by Family Companies have come to light through public court cases such as the quarrel between brothers that escalated into Republic v Chief Magistrate Milimani & another Ex-parte Tusker mattresses Ltd & 3 others [2013] eKLR.

1.1.1. Definition of Family Companies

Chapter 2 of this study will delve into the character of Family Companies, but it is important to create a common understanding of what is meant by the term Family Company in this study. Globally no jointly accepted definition of Family Owned Companies exists, largely due to the diverse interpretation of the term ‘family’, but also as a result of the varied legal frameworks and cultures in which these

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entities exist. Family Business studies are yet to illuminate a universal definition of the term Family Company.

Entire studies have been conducted to review and contrast existing definitions of Family Businesses and the overall conclusion of these studies remains that there lacks a profound consolidation of what exactly is meant by family business\textsuperscript{11}. This creates a predicament for scholars who wish to examine Family Companies.

With such an ambiguous subject, the prudent option for academic scholars looking at Family Companies in various disciplines is to identify the most relevant, and globally applicable definition of a Family Company to each study. In this study, the definition adopted by the IFC in its 2008 Family Business Governance Handbook was found to be most suitable. This is because, the Handbook focused on the global corporate governance challenges faced by family businesses and in doing so, provided a global perspective on family businesses thereby providing an appropriate foundation for this study to ground its working definition of the term Family Company.

Consumers of this study are therefore expected to adopt the definition proposed by the IFC and understand the terms Family Company, Family Business and Family Owned Company (FOC) as used interchangeably throughout this study to mean “a company where the voting majority is in the hands of the controlling family; including the founder(s) who intend to pass the business on to their descendants”.

1.1.2. Corporate Governance in Kenya

Historically, the global development of corporate governance has been reactive to corporate scandals. This has resulted in corporate governance practices being designed to protect the interests of powerful institutional investors from the disastrous economic effects of unscrupulous corporate practices. The situation is no different in Kenya.

There has been growing emphasis on promoting good governance in companies in Kenya. The revised Companies Act No. 17 of 2015 introduced several new corporate governance standards and measures; the Code of Corporate Governance for State Corporations (Mwongozo) and the Code of Corporate Governance for Private Companies were issued by the Institute of Certified Public Secretaries in 2015, and the Capital Markets Authority recently issued a Code of Corporate Governance Practices for Public Listed Companies in Kenya which came into force in 2017.

Notwithstanding the seemingly robust development of laws, regulations and codes to improve corporate governance in Kenyan Companies, the Kenyan public has been audience to numerous court cases involving Family Companies as a result of poor corporate governance practices. Three out of the four largest family owned supermarket chains in Kenya have made headlines in a public display of governance structures that are fraught with complexity, informality, poor reporting and lack of clarity in the roles of the family. In the case of Nakumatt, questionable corporate governance practices which in turn led to a lack of proper internal controls have contributed to the retailer battling a suit filed against it by several creditors who are demanding over Kshs. 4 billion\(^\text{12}\). It is quickly becoming apparent that the application of good corporate governance practices to individual, family and faith-based organizations has been neglected by the corporate governance wave that seems to be sweeping the country.

\(^{12}\text{Nakumatt Holdings Limited vs. The Junction Limited [2017] eKLR}\)
It is against this backdrop that this study will examine the existing corporate governance framework in Kenya in an effort to establish whether it is adequate to support Family Companies.

1.2. Statement of Problem

Despite policy and statutory reform, and the steps taken by various institutions to improve corporate governance practices in Kenya, Family Companies which contribute to a significant portion of the Kenyan economy, still struggle with implementing good corporate governance practices. This study attributes this struggle to a disconnect between the existing corporate governance framework and the unique nature of the corporate dynamics present in Family Companies. The struggle has been manifest in the public family squabbles and the instability experienced in the Kenyan market, particularly in the retail sector. The numerous court cases against family members (Tuskys and Naivas) and the insolvency proceedings instituted against the former leading Family Company in the retail industry – Nakumatt\textsuperscript{13} are clear indicators that all is not well. This begs the question: Is the existing corporate governance framework sufficient to address the unique governance dynamics present in Family Companies?

1.3. Justification of the Study

Family Companies are great contributors to the Kenyan economy\textsuperscript{14}. Therefore, developing an understanding of their nature, the challenges they face and the probable solutions to these challenges is imperative. The prevalence of Family Companies means that the majority of the Kenyan public are stakeholders in these entities and that the majority of the Kenyan society is affected by the operations of these Companies.

\textsuperscript{13} Ibid.

\textsuperscript{14} PricewaterhouseCoopers (n 9) 3
Despite considerable growth and development in the corporate governance framework in the past few years, there are still no developments in corporate governance as relates to Family Companies. Further, as indicated above, there has been a recent increase in the number of court cases that have arisen as a result of questionable corporate governance practices in Family Companies. Given their import to the economy, there is a need to give governance in Family Companies attention and identify the steps that need to be taken to support their existence.

An investigation of the governance disputes that have arisen in Kenyan Family Companies would assist in appreciating the governance challenges that contributed to these disputes. This will assist in putting in place measures to avoid similar disputes, and highlight areas for improvement of the existing framework governing the operations of Family Companies.

As will be discussed in the literature review, a host of studies on family companies have been conducted worldwide but few studies concern themselves with the situation in Africa, or Kenya for that matter. This study will demonstrate that there is a need to provide specific regulation and institutional support to Family Companies in Kenya.

1.4. Research

1.4.1. Research Methodology

The research methodology adopted in this study will comprise documentary research methodology to examine the laws regulations and codes making up the corporate governance framework in Kenya, case study methodology to identify the challenges faced by specific Family Companies and international and comparative research methodology to identify best practices for governance in
Family Companies. This is therefore a secondary research assignment as it is based on gathering of existing information from credible and recognised sources\textsuperscript{15}.

The study is qualitative as it is anticipated that is findings will lead to an informed conclusion on what measures need to be taken to improve the adoption of good corporate governance practices for Family Companies.

The primary sources of the study will include the Companies Act, 2015, the Capital Markets Act (Cap 485A of the Laws of Kenya) and its attendant codes, the ICS Code of Corporate Governance for Private Companies, the Principles for Corporate Governance in Kenya and Sample Code of Best Practice for Corporate Governance prepared by the Private Sector Corporate Governance Trust (PSCGT), the IFC Family Business Governance Hand Book and relevant decisions made by Kenyan Courts.

As secondary sources of information, this study will make use of library research tools (both digital and manual) including books, scholarly articles, newspaper articles internet sources and newsletters.

1.4.2. Research Objectives

The overall objective of the proposed study will be to build a case for a review of the corporate governance framework in Kenya to address the needs of Family Companies. Specifically, the study will strive to:

1. Highlight the unique nature of corporate governance in family companies;

\textsuperscript{15} Mary Ngechu, \textit{Understanding the Research Process and Methods} (University of Nairobi 2010) 11
2. examine the existing corporate governance framework in Kenya and ascertain the key insufficiencies in existing laws in dealing with the unique challenges faced by Family Companies;

3. review some of the global governance practices and the governance framework within which Family Companies successfully operate in other jurisdictions; and

4. identify ways in which corporate governance in Family owned Companies in Kenya can be improved.

1.4.3. Research Questions

In achieving the above objectives, the study will seek to answer the following research questions:

1. What differentiates governance in Family Companies from governance in other companies?

2. Is the existing corporate governance framework sufficient to address the unique governance challenges faced by Family Companies?

3. How have other jurisdictions dealt with corporate governance in Family Companies?

4. What can be done to make the Kenyan corporate governance framework more effective in dealing with the governance challenges faced by Family Companies?

1.4.4. Limitations

The anticipated limitations of the study include:
1. Limited access to information due to the secretive nature of the operations of Family Companies. As such, the study will be limited to information that is in the public domain which may not accurately depict the status of the subjects of the study.

2. The scope of the study will be limited to the Kenyan context but will highlight global best practices and a selected jurisdiction to compare to the Kenya corporate governance framework.

1.4.5. Hypothesis

This study is based on the following assumptions:

1. Family Companies have a unique corporate character results in corporate governance challenges;

2. The current corporate governance framework in Kenya does not adequately protect the unique nature of Family Companies and is inadequate to address their unique challenges; and

3. There exists a need for a review of the corporate governance framework as relates to private companies, coupled with the development of a comprehensive and detailed Code of Corporate Governance for Family Companies in Kenya.

1.5. Theoretical Framework

Globally, the concept of corporate governance has taken centre stage due to the worldwide wave of privatization, deregulation and the integration of capital markets in the past two decades, global
financial crises and a series of recent scandals and corporate failures\textsuperscript{16}. However, as noted above, corporate governance seems to have been devised for the benefit of largescale institutional investors in private companies. The adoption of good corporate governance practices to safeguard the interests of stakeholders is a globally accepted trend backed by several theories that have been developed over time. These theories provide a foundation for this study of corporate governance in Family Companies and will be briefly highlighted below, before an in-depth review in Chapter Two.

1.5.1. Agency Theory

The agency theory is a core theory in corporate governance. It seeks to address the question: ‘for whose benefit does the firm exist?’, and in doing so it looks at the relationship between the owners of a company and the management as one of agency. Jensen and Meckling\textsuperscript{17} were the first notable contributors to this theory. In their 1976 research paper titled ‘Theory of the firm: Management, Behaviour, Agency Costs and Ownership Structure’, they analysed property rights, agency and finance and significantly developed the understanding of the agency relationship between shareholders and owners.

Jensen and Meckling defined agency as ‘a contract under which one or more persons engage another person to perform some service on their behalf which involves delegating some decision-making authority to the agent’\textsuperscript{18} and proceeded to argue that this definition perfectly describes the relationship between the owners of a Company and the Management.

\textsuperscript{16} Moche, (n 8), at pg 1.
\textsuperscript{18} Ibid
Their research though insightful on the agency relationship existing within corporations, focused largely on the risks and costs incurred within an organisation as a result of the agency theory. Indeed, Jensen and Meckling admit that they ‘confine…attention…to only a small part of this general problem—the analysis of agency costs generated by the contractual arrangements between the owners and top management of the corporation’\(^{19}\).

Chapter 2 of this study will focus on the agency theory as it applies to Family Companies, as it provides a foundation for the different roles family members play within these entities. It is worth noting that the agency theory led to the development of the shareholder theory which avers that it is the sole responsibility of management to maximise profits for the benefit of shareholders as hired agents, and therefore management is morally obliged to serve shareholder interests. This theory was eventually overtaken by the stakeholder theory, a core corporate governance theory in the study of Family Companies that will be discussed in brief below.

1.5.2. Stakeholder Theory

The stakeholder theory was developed following the agency theory and the shareholder theory. It proposes that a company owes a responsibility not just to shareholders by virtue of the agency relationship but to a much larger group of interested parties including employees, customers, suppliers, regulators and the society at large. Edward Freeman was the major proponent of this theory. In his 2002 "Stakeholder Theory of the Modern Corporation" Freeman summarises the stakeholder theory as follows:

"My thesis is that I can revitalize the concept of managerial capitalism by replacing the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary

\(^{19}\) Ibid
relationship to stake-holders. The crux of my argument is that we can re-conceptualize the firm around the following question. For whose benefit and at whose expense should the firm be managed?"^{20}

Given that the theory explores the relationship between companies and their stakeholders, this theory is pertinent in any analysis of Family Companies to enable the identification of the stakeholders affected by Family Companies and the measures that need to be adopted to protect the interests of these stakeholders. This study will examine the impact that the Family has in Family Companies as a stakeholder, and this theory provides the basis for such examination.

1.5.3. **Resource Based View Theory**

The Resource Based View Theory (RBV Theory) started gaining traction in 1991 when it was formalised into a theoretical framework\(^{21}\). The main premise of this theory is that a firm’s internal idiosyncrasies are identified as a key factor in its competitive advantage. In this management theory, the unique nature of a firm is invaluable and therefore should be understood and analysed to ensure full exploitation of a firm’s potential.

Chapter 2 of this study will highlight how this theory has been used to argue that Family Companies have unique traits stemming from their family ownership which gives them a competitive advantage, that should be maintained and honed to enhance their market performance.

In acknowledging this special competitive advantage that Family Companies have, as identified by the RBV Theory, the need to protect this key advantage within the corporate governance framework

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becomes evident. This further validates the need to interrogate whether such protections are afforded within the existing Kenyan corporate governance framework.

### 1.5.4. Social Emotional Wealth Theory

Like the RBV Theory introduced above, the SEW Theory is useful in underscoring the differences between Family Companies and other firms and the underlying value arising from these differences. Unlike the RBV Theory which looks at these differences from a competitive advantage, the SEW Theory looks at the impact these differences have on a company’s strategy.

Its main premise is that the family derives benefits from the social emotional influence that it has over a Family Company which is absent in other forms of companies. This social emotional influence then becomes a factor in the company’s strategic direction. The SEW theory highlights the relationship between the perception of the value of this influence as wealth and then illustrates the effect of this influence by describing how family control, family identity, social ties, emotional attachment and dynastic succession become factors that affect the company’s strategic decisions.

These strategic social emotional influences determine the structure and culture of Family Companies, and any code of governance that applies to Family Companies should recognise this influence and cater to this aspect of the Family Company.

### 1.6. Literature Review

Due to the dominance of Family Companies globally there exists extensive literature on the application of good corporate governance within Family Companies. Recent literature on this topic can be grouped broadly into two thematic areas: International Best Practices in Corporate Governance for Family Companies and Local Governance in Family Companies.
1.6.1. Literature on International Best Practices for Family Companies

The IFC has published a comprehensive handbook on corporate governance in family business as a general guide to help their staff identify and address basic family business governance issues and to operate as a guidance tool for their clients looking to strengthen their family governance practices\(^{22}\). It is worth noting that this handbook only highlights Family Businesses in Europe and Latin America, and although the principles are global, the book does not look at any Kenyan family businesses. This handbook will be analysed further in the following Chapters of this study, particularly Chapter 4 which examines international best practices of corporate governance in Family Companies.

Sir Adrian Cadbury\(^{23}\) wrote a report seeking to highlight the very particular advantages and challenges of family firms in a highly competitive global economy. Just like this study endeavours to do, his study identifies the difference between Family Companies and other types of Companies and also uses case studies to demonstrate the corporate governance structures within Family Companies. His report, though comprehensive, focused on the European, Latin and Asian companies and did not focus on the Kenyan context.

Alfred Sarbah and Wen Xiao tackled the state of corporate governance environment and the nature of the governance system employed by family businesses using Ghanaian family businesses as a case

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\(^{23}\) Sir Adrian Cadbury, ‘Family Firms and their Governance: Creating Tomorrow’s Company from Today’s’ (Egon Zehnder International, 2000)
The approach used in this study was indeed comprehensive and the structure of Sarbah and Xiao’s study will be borrowed and applied to the Kenyan context from a legal perspective in this study.

Jaffe and Lane discuss the key challenges that a family must face to create an effective dynasty over generations, which include the establishment of corporate governance structures and succession plans, in their article “Sustaining a Family Dynasty: Key Issues Facing Complex Multigenerational Business and Investment Owning Families”25.

Andreas Kallmuenzer in his Chapter in the book ‘Theoretical perspectives on family businesses’ entitled “Agency Theory and the Family Business”, looks at the application of the corporate governance Agency Theory on Family Companies globally. His writings are more theoretical in nature and elucidate relevant research about the agency perspective, from its origin in financial research to its application and adaptation in family business research26. He does not concern himself with the examination of corporate governance in Family Companies.

Paolo Di Toma and Stefano Montanari in their Article “The Definitional Dilemma in Family Business Research: Outlines of an Ongoing Debate”27 study the issues faced in defining the term Family Business from a worldwide academic perspective. The study looks at the characterization of Family Business27.

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Firms based on their governance by family members but does not look at the application of corporate governance principles within Family Firms.

1.6.2. Local Literature on Governance in Family Owned Companies

Stephen Warui Moche\textsuperscript{28} writes about the specific emphasis on corporate governance and performance of family-owned businesses that are listed on the securities exchange. He took an empirical approach, and focussed on the financial performance of the listed companies based on their implementation of various corporate governance measures. Though his study is specific to Kenyan Companies; it did not measure the adequacy of the existing corporate governance framework to address the challenges faced by Kenyan Family Companies.

Rotich Edward\textsuperscript{29} determined the effect of succession planning on financial performance of family owned supermarkets in Nairobi County. His study focussed on the positive effect of succession planning on financial performance of family owned supermarkets. While his study showed a direct connection between the good financial performances of family owned businesses with the establishment of proper succession planning structures, the study did not delve into corporate governance challenges and structures within Family Owned Companies.

The evolution of corporate governance in Kenya is examined by Rita Ruparelia and Amos Njuguna of the Chandaria School of Business\textsuperscript{30}. Their article provided a useful basis for a brief examination of the historical development of corporate governance in Kenya, however a study of the historical

\textsuperscript{28} Moche (n 8)
\textsuperscript{29} Rotich, Edward K, ‘The effect of succession planning on financial performance of family-owned supermarkets in Nairobi county’ (Msc thesis, University of Nairobi School of Business 2014)
\textsuperscript{30} Rita Ruparelia and Amos Njuguna, ‘The Evolution of Corporate Governance and Consequent Domestication in Kenya’ (2016) 7 11
development of corporate governance in Family Companies in Kenya was required. An attempt to summarize the history of family companies has been included in Chapter 2 of this study.

Lois Musikali wrote on ‘The Law Affecting Corporate Governance in Kenya: A Need for Review’ in the 2008 International Company and Commercial Law Review. In her article, she interrogates whether Kenya can achieve good corporate governance in the (then) current state of its law. Just like the preceding article, this study was useful in developing a broad understanding of the development of corporate governance in Kenya, and further on the loopholes that were present in the corporate governance framework in 2008, some of which are still present and have been highlighted in Chapter 3 of this study. As this article looked broadly at corporate governance in Kenya, there was still a further need to specifically look at whether Family Companies can achieve good corporate governance within the current Kenyan corporate governance framework.

Even though there are wide-ranging materials available on corporate governance in Family Companies there is no comprehensive study of this phenomenon in the Kenyan context. It is hoped that this study will fill this literary gap, and possibly create further areas of research in the academic field of corporate governance in Family Businesses.
CHAPTER TWO

THE CHARACTER, THEORY AND GOVERNANCE CHALLENGES OF FAMILY COMPANIES

2.1. Introduction

This Chapter looks at the conceptual framework of Family Companies. The character of family companies is examined in the first part of this chapter, followed by a look at the underlying theories that form a foundation for the arguments advanced in this study. Finally, the corporate governance challenges faced in Family Companies and a few illustrations of these challenges using case studies from the Kenyan retail sector will close the chapter.

2.2. Understanding Family Companies

Any discussion on the impact of the corporate governance framework in Kenya on Family Companies, would inevitably give rise to the question: what is the difference between Family Companies and other companies? Aren’t the governance requirements the same? Therefore, to create a base understanding of the exceptional nature of Family Companies, the first part of this chapter will deal with the history and characteristics of Family Companies in order to distinguish the Family Company from other types of companies.

2.2.1. History of Family Companies

It has been said that the family firm is a form of productive organisation whose origin is impossible to locate precisely in space or time. Family members have worked together since the beginning of time.31 Andrea Colli, ‘The History of Family Business, 1850–2000’ (Cambridge University Press 2002) <http://ebooks.cambridge.org/ref/id/CBO9780511615009> accessed 26 November 2019.
– from Adam and Eve who arguably started the first textile industry, to Joseph and his brothers who can be said to have led a multinational cereal enterprise – there is no exact beginning of the family company.

In the African context, extended families historically worked together to cultivate their crops and rear livestock to meet their basic needs, and the needs of the community at large. In Kenya, the family business form has expanded over history from small scale family farming and ‘dukawallas’ to include large scale manufacturing and financial empires. The Ramco Group for example, which is one of Kenya’s oldest and largest family owned companies, was started in 1948 as a hardware store in downtown Nairobi and has grown to be a highly diversified organisation comprising 35 companies operating in five sectors: print, hardware, manufacturing, stationery and services with 3,800 employees. It is also worth noting that some Family Companies in Kenya were unwittingly the product of statute. In order to meet the requirement set out in the 1962 Companies, Act CAP 486 (Now Repealed) to have at least two shareholders in a Company, many founders allotted shares to their wives and progeny thus establishing Family Companies as a dominant form of asset holding and business companies in Kenya.

2.2.2. Characteristics of Family Owned Companies

The first and most obvious differentiating characteristic that flows directly from the adopted definition is that Family Companies are controlled by members of the same family. This type of control means that a single family is able to influence decisions within a company, a feature that is unique to Family

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33 Companies Act CAP 486 (Now Repealed) s 4
Companies. In the Kenyan owned Chandarana Supermarkets for example, it is reported that nearly 50 years after its establishment, the founder’s sons are still the only directors in the company. This illustrates the singular control exercised by the family of the founder of the Company.

The second distinct characteristic that emerges is that the transfer of ownership from one generation to another is, ideally, planned by the controlling family, typically within the controlling family. While in other types of private and public companies, the owners have little in common except for an interest in shares, ownership in Family Companies is characterised by shared bloodlines, matrimonial ties and legacy interests. This results in social and emotional ties in the company that have a direct effect on decision making within the company and on the overall strategy of the company.

The third differentiating factor would be their structure and behaviour. Family Companies are also said to have a distinct organizational structure and behaviour. Compared with other entities, Family Companies have globally been characterised as slow growing, proponents of ‘flat’ organisational structures and internal succession patterns; relying upon self-financing or on local, often informal credit sources and avoiding stock-market finance… and less profitable than managerial ones. In Kenya however, Family Companies have been characterised as more entrepreneurial, more streamlined and able to make decisions more quickly than non-family businesses.

Research has shown that family firms have unique advantages due to (1) organisational authority being in the hands of the family; (2) the family having shared goals that avoid the need for incentives to a certain degree; and (3) family firms being independent of external accountability.

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35 Colli (n 31) 7
36 PricewaterhouseCoopers (n 32) 4
37 Kallmuenzer (n 26) 68
In performance, several studies have shown that Family Companies outperform their non-family counterparts in terms of sales, profits, and other growth measures. This high performance has been attributed to their strong sense of commitment to the long-term growth of the company, the knowledge continuity, accumulation and transfer across generation to generation and their high value of reputation within their operating environments.

From a legal perspective, Family Companies have the same statutory characteristics as any other company under Kenyan laws. Indeed, the Companies Act provides a broad definition for any company as meaning a company formed and registered under the Act. As we will see later in Chapter 3 of this study which will deal with the recognition of Family Companies under Kenyan law, the Companies Act merely seeks to define family interests for purposes of governing conflicts of interests that may arise. While the basic legal structure of Family Companies (shareholders, directors, secretaries and auditors) is the same as other companies under Kenyan statute, the governance problems experienced by Family Companies would suggest a need to put legal structures and requirements in place to enhance the governance in these entities, as will be seen below.

The above differences have provided fodder for the development of the Family Business Research field. While the Family Business Research field is still relatively new, it has been established as an academic field in its own right and has produced theories that illustrate the immense value in the character of Family Companies. Some of these theories will be discussed in the following sections.

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38 IFC (n 22) 12
39 Companies Act, 2015 s 3
40 Companies Act, 2015 s 564
2.3. Corporate Governance Theories in Family Owned Companies

As stated in Chapter 1 of this study, the underlying traditional legal and corporate governance theories that apply in this study are the Agency Theory as advanced by Jensen and Meckling in their 1976 work, and the Stakeholder Theory first advanced by Freeman in 1984. They provide the foundational theoretical framework against which modern Family Company Theories can be built. These two theories will be discussed in detail in the next few sections, followed by the more modern Resource Based View Theory and the Social Emotional Wealth Theory which provide a sociological theoretical framework to the corporate governance dynamics within Family Companies.

2.3.1. Agency Theory

From its origins in financial research, agency theory has become one of the more predominant theories applied and further developed in family business research and corporate governance fields. The Agency Theory in its simplest form proposes that the firm’s owners (principals) hire managers (agents) and then delegate the firm’s day-to-day operating decisions to these managers. The theory was a welcomed breakthrough in the theory of the firm as it identified the various variables within a firm and their divergent interests.

The Agency theory proposes that both the owners of a firm and the managers have their own ends and seek to maximise their own personal goals within the firm. For the owners of the Company, identified as shareholders, the maximization of their interests is the long-term maximization of profits and earnings on their shares. For managers on the other hand, their interests are catered for in the short term where they can benefit from the firm’s performance during their tenure. The delicate act of

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41 Kallmuenzer (n 26) 58
42 H Kent Baker and Ronald Anderson (eds), Corporate Governance: A Synthesis of Theory, Research, and Practice (Wiley 2010) 3
balancing these opposing interests results in agency costs. Agency costs can be seen as the value loss to shareholders, arising from divergences of interests between shareholders and corporate managers\textsuperscript{43}. Agency costs are generally classified into monitoring costs, bonding costs, and residual loss. Good corporate governance practices are needed to develop corporate structures and practices to manage the agency costs.

In many family firms, the dynamic between the principals and the agents identified in the agency theory plays out differently. Management and owners come from the same family. This is especially true in the first years of existence of Family Companies, where the family business is usually directed and managed by the founder(s) and the decision-making power is concentrated in the hands of a few close relatives\textsuperscript{44}. For family firms, it is often assumed that because ownership and management have family interests in common, they are aligned. However, the influence of family-related issues aside from business interests in family firms creates a more complex structure of individual preferences and utility maximization\textsuperscript{45}.

Family relations between the principal and agent add a new layer to utility and may to some extent align their interests. Family owners have different investment objectives from normal shareholders because family managers are likely to have a much longer investment horizon than nonfamily managers. The same applies to the owners\textsuperscript{46}. For example, a manager who is part of the family may not be a shareholder owner, but by virtue of his family relationship with the owners, would take a

\textsuperscript{44} IFC (n 22) 46
\textsuperscript{45} Kallmuenzer (n 26) 58
long-term interest in the performance of the company for the benefit of his progeny similar to an owner. This alignment of ownership and management interests is often considered to be a requirement for being defined as family firm\(^47\).

While the family relations between the principal and agent would seem to minimize the principal agent problem and the associated agency costs, they do create a new set of agency challenges. Findings show that management entrenchment, and thus higher agency costs, occur more frequently in family firms compared to non-family firms because relational contracts are often based on emotional values instead of rational criteria, neglecting the sensitivity to risk-taking or weak performance\(^48\).

By way of illustration, in a non-family owned company, the owners employ agents based on their suitability for the role – their ability to meet the owners needs through profit maximization. In this instance the separation of ownership and management interests would lead to efficiencies that would generally benefit the performance of the Company. On the other hand, in Family Companies, the issue of employing family members comes into play for the owners which may result in decreased efficiencies in the family firm as opposed to the non-family firm. Hiring based on blood and not on merit considerations hinders efficiency\(^49\). Non-family employees may not be as motivated by short term interests in family firms due to perceived unfair employment practices leading to subdued performance. Corporate governance practices in Family Companies would need to recognise such dilemmas and put in place the attendant structures and practices to mitigate such issues. This may

\(^{47}\) Kallmuenzer (n 26) 63  
\(^{48}\) Ibid 68  
\(^{49}\) Morten Bennedsen, Francisco Perez Gonzalez and Daniel Wolfenzon, ‘The Governance of Family Firms’ in H Kent Baker and Ronald Anderson (eds), Corporate Governance (John Wiley & Sons, Inc 2011) 379  
include policies, not only on hiring of family members but also on the benefits to which family executives are entitled, to ensure that they remain sufficiently motivated.

The multiple roles held by family members as either owners, managers or directors are also usually associated with different incentives, which increases the challenges that family businesses face as opposed to their non-family counterparts\textsuperscript{50}. Regardless of the agency problems that may play out in a family firm, studies have concluded that agency threats are generally lower in family firms than in non-family firms\textsuperscript{51}.

One major application of the Agency Theory to the corporate governance practices in Family Companies can be seen in the recommended practices dealing with employment and senior management in Family Firms. For example, it is recommended that a Family Company establishes a clear family employment policy which would aid in defining the principal agency relationship arising therefrom. It is also recommended that the Family Company establish a remuneration system that provides the right incentives to both family and non-family employees, which would manage the principal agent relationship\textsuperscript{52}.

\section*{2.3.2. Stakeholder Theory}

As seen above the Agency Theory takes the position that the firm exists for the benefit of its shareholders and identifies the challenges that arise from this presupposition. The stakeholder theory on the other hand suggests that the corporate firm is operated for the benefit of a broad range of stakeholders. According to the stakeholder theory, the corporation is entirely dependent on its

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\item \textsuperscript{50} IFC (n 22) 17
\item \textsuperscript{51} Kallmuenzer (n 26) 70
\item \textsuperscript{52} IFC (n 22) 47
\end{itemize}
\end{footnotesize}
stakeholders’ resources to create value, and it considers stakeholders’ interests as critical for sustaining corporations and their value-creation activities\textsuperscript{53}. This means that stakeholders hold as much of an interest in the firm as the shareholders who provided capital and are entitled to the residual value of the company.

The stakeholder theory is pertinent in studying corporate governance in Family Companies because it creates a foundation for understanding the basis of the duties owed to the main stakeholder in any Family Company – the Family. The Family interest is a crucial stakeholder interest in Family Companies, and, from the definitions covered in the preceding chapters, one could even say the that the family interest gives the Family Company its inimitable definition and identity.

The stakeholder theory requires that a business has a responsibility to maximise the economic benefit of the business’s operations for its stakeholders. This study will examine whether the existing Kenyan corporate governance framework allows for such profit maximization by families as key stakeholders in Family Companies.

It is worth noting the stakeholder theory has been extremely influential in corporate governance practices and is widely recognised in corporate governance codes. The OECD Principles of Corporate Governance for instance, now recognize the inherent interdependence between a firm and its stakeholders\textsuperscript{54}. This is also codified in the various codes of corporate governance including the Kenyan Codes. While the emphasis of duties owed to various stakeholders is openly recognised by corporate governance as can be seen from the emphasis on Corporate Social Responsibility and Environmental


Social and Governance obligations, there seems to be a blind spot in corporate governance when it comes to stakeholder duties owed to the Family. Further, in their internal operations and governance Family Companies often give too much emphasis to the family as the only stakeholder. Family businesses management that does not provide stakeholder balance will lead to conflicts and loss of other stakeholders and workers over time which would endanger the sustainability of the business\textsuperscript{55}.

A code seeking to provide for corporate governance practices in Family Companies would therefore not only need to acknowledge families as crucial stakeholders in the governance of a Family Company, but also to put in place recommended practices to deal with the tension of balancing the family interests against other stakeholder interests.

2.3.3. Resource Based View Theory

The Resource Based View (RBV) Theory of the firm is primarily a strategic management theory that seeks to explain why among similar firms there is outperformance of the rest by a few. This theory is relevant to this legal study mainly because it provides a justification for the need to protect the unique identity of Family Companies within the Kenyan corporate governance framework. This is because, when applied to Family Companies, the RBV Theory points to the fact that the Family Companies have an invaluable competitive advantage in maintaining their identity.

\textsuperscript{55} çini mehmet akif, Güleş HK and Aricioğlu MA, ‘Effect of the Stakeholder Salience Theory on Family Businesses Performance’ (2018) 17 Gaziantep University Journal of Social Sciences 1473
The RBV theory was first named by Birger Wernerfelt in his article “Resource Based View of the Firm” (1984) and later developed by Rumelt (1984) and Barney (1986), who focused on the analysis of firms’ internal resources and their link to competitive advantage. According to the RBV theory of the firm, in dynamic and efficient markets, a realistically sustainable competitive advantage must inevitably be rooted in some unique or idiosyncratic resource controlled by the firm. In the case of Family Companies, this unique resource is family ownership and control.

The RBV theory has gone ahead to identify ‘familiness’ as a unique component of Family Companies that gives them a competitive advantage in their various industries. Familiness here is viewed as the bundle of resources that are distinctive to a Family firm. It can be further understood to mean the Family’s influence on the respective firm, which leads to a competitive advantage that, finally, is transformed into performance. Examples of this ‘Familiness’ include the Family Company’s reputation which establishes credible commitment, the Family’s investment in a substantive vision, mission and the required capabilities, the Family’s investment in people, especially in transferring knowledge creation and preservation from generation to generation and the fiduciary relationship that exists among the partners.

The RBV theory therefore recognizes the value that Family Companies have a distinct character that gives them a competitive advantage over other types of companies, and it is on this basis that this

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56 Hansson (n 21) 258
58 Hansson (n 21) 263
59 Bennedsen, Lez, Wolfenzon (n 49) 379
60 Hansson (n21) 264
61 Capasso (n56) 13
study argues that Family Companies need to be able to maintain their identity within existing corporate governance frameworks.

Chapter 3 of this study will look at the treatment of “familiness” under the existing Kenyan Corporate Governance Framework, while Chapter 4 will examine how this phenomenon has been protected and maintained within the Brazil corporate governance framework as well as in the IFC Governance Handbook for Family Companies.

2.3.4. Social Emotional Wealth Theory

The final foundational theory for this study is the Social Emotional Wealth Theory (SEW Theory). Like the RBV theory above, this theory adds value to the proposal in this paper that the Family Company has a unique identity that requires protection from dilution and accommodation in matters corporate governance. This approach focuses on the importance of the social and emotional interests of family firms.\(^{62}\)

The SEW theory is a behavioral agency theory that proposes that firms make choices depending on their core principles. Family Companies in particular make strategic decisions based on their family principles. It is advanced that key among the principles a Family Company would hold is that of family recognition. Family business owners are often ready to sacrifice economic gains in order to maintain or restore their family recognition and in doing so, the core of the SEW is found in family’s inclination for recognition.\(^{63}\)

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\(^{62}\) Kallmuenzer (n 26) 66  
Social Economic Wealth refers to the stock of affect-related values that an owning family derives from its family business\(^{64}\). SEW Theory seeks to explain the social emotional influences on a company’s strategic choices and the perceived value of these social emotional influences within firm. The five dimensions of SEW proposed by Berrone\(^{65}\) and their relationship with various aspects of corporate governance in Kenya are highlighted below:

a. Family control and influence: This is an ideal that is desired and maximised in Family Companies. Many Family Companies will make decisions based on the need to maintain family control and influence. In looking at Nakumatt Holdings for example, it is reported that numerous offers from potential investors were turned down by the majority shareholder (the Shah family) in an attempt to maintain control over the firm, just before it was placed under administration\(^{66}\).

b. Identification of family members with the firm: In this aspect, the family identity and the firm’s identity are intertwined and the family places a huge value on its reputation, and that of the family company. Strategic decisions are therefore made to protect the joint identity of the family and family company. It would be important for corporate governance practices to recognise this facet of SEW and ensure that the structures in place allow for transparent and effective decision making to preserve the family’s identity. It is reported that family members identify more strongly with their family firms than non-family members, and the heightened identification motivates family members to pursue a favourable corporate reputation\(^{67}\). By way of illustration, the recommendation that a Family Firm have a majority of their directors being independent and non-

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\(^{64}\) Ibid


\(^{66}\) Ibid

\(^{67}\) Qing Lan (n 63)
executive that is common in Kenyan codes of corporate governance would conflict with the family’s need to maintain their family identity within the firm. The same can be said for the position of the Chairman of the Board, which is normally reserved for the Family patriarch or matriarch.

c. Binding social ties: Closely related to point (b) above, this dimension of the SEW theory proposes that Family Companies create strong bonds not just within the family but also with their external stakeholders. Wider stakeholder interest, employment and social initiatives like schooling for young children and scholarships were listed as the objectives of a fourth-generation family business owner in Kenya\textsuperscript{68} which illustrated the motivation behind the Companies strategic decisions. Good corporate governance practices in Family Companies should aid these social ties as part of the stakeholder relations requirements to ensure that Family Companies maintain their SEW. The requirement to have a family constitution to capture these values is an example of a corporate governance measure that can be taken to enhance and protect a company’s social economic wealth.

d. Emotional attachment: This is rather self-explanatory in that Family Companies demonstrate a much higher emotional attachments to the firm by their owners and management. This emotional attachment should be recognised and managed within the corporate governance framework of the Family Company. This is achieved through the creation of for a where emotional issues can be dealt with such as in a Family Assembly or Family Council.

\textsuperscript{68} PricewaterhouseCoopers, (n 32) 17
e. Renewal of family bonds to the firm through dynastic succession: This relates to the maintenance of the business for the benefit of future generations. Succession should therefore be a crucial component of any corporate governance framework affecting Family Companies to allow for such renewal of bonds across generations. Emphasis should be placed on the development of a succession plan in any code that applies to Family Companies. The Code should also recommend for sharing of the succession plan within the Family Company to aid in transparency and accountability.

The SEW has been used widely to distinguish the behaviours of family firms from their counterparts and as can be seen in the preceding paragraphs, justifies the need to consider the specific traits of Family Companies within any corporate governance framework.

The theory behind corporate governance in family owned companies builds a case for the unique character of Family Companies and their need for a ‘custom-made’ form of corporate governance to be adopted to sufficiently address their particular challenges. The theoretical framework above further underscores the value in the identity of Family Companies being maintained. The next and final section of this Chapter will illustrate some of the corporate governance issues faced by Family Companies, specifically Kenyan Family Companies in recent history, before the examination of the existing Kenyan corporate governance framework affecting Family Companies in Chapter 3.

2.4. Corporate Governance Challenges in Family Owned Companies

The unique dynamic created by the underlying relations between the owners, management and employees of Family Companies creates exceptional governance considerations for Family Firms.

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69 Qing Lan (n 63)
The special governance weaknesses faced within Family Companies can be traced to several factors. The inclusion of the family variable to the ownership-management governance matrix results in a more complex governance structure.

The family dynamic also adds an element of informality in the company, especially at the early stages of the family company’s life. This level of informality can be an advantage in that the lack of bureaucracy results in flexibility and fast decision making as seen in the characteristics of Family Companies discussed in the earlier portion of this chapter. However, it creates a grey area in governance which results in lack of clear controls, as well as a lack of transparency and accountability within the family owned company without the proper governance structures in place. Fairness and transparency in financial and non-financial perks and reward systems, particularly within the family, are essential tools in avoiding tensions over perceived injustices\(^\text{70}\).

The relations between family members within a family owned company may also result in a lack of discipline in managing the affairs of the company which stems from a lack of objectivity. This can be seen especially in traditional African settings where children (mostly sons) believe they are entitled to the family business, and are not able to cultivate the discipline and skills to effectively manage the business. Another grounds for lack of objectivity is the separation of roles within the family between those who are engaged in the business and involved in its management, and those who are not. Family members engaged in the company may see themselves as doing the work and carrying the responsibility, while their relations enjoy the results and are free to criticise their efforts into the bargain\(^\text{71}\). On the other hand, the members of the family who are owners but not managers tend to

\(^{70}\) Sir Cadbury (n 23) 3
\(^{71}\) Ibid 11
assume that their interests as shareholders are being subordinated to the interests of those managing the firm.

A lack of the necessary firm structures to train the next generation compounds the situation, and this unfortunate story often culminates in many thriving family businesses being run to the ground by the second or third generation. The recent happenings in the estate of the late Njenga Karume and in the estate of the late Gerishon Kirima, former Member of Parliament for Starehe, where billion-shilling estates have been run to the ground by the second generation are examples of how the lack of a succession plan can negatively impact the success of a Family Company\(^\text{72}\).

Family firms are similar to other firms with concentrated ownership because decision making is often concentrated in a few hands\(^\text{73}\). Institutional investors often appoint the managing directors in their investment companies. One would be tempted to imagine that the corporate governance adopted in non-family firms would address the challenges faced in family firms as well. This is not the case as changes in common governance mechanisms often fail to bring about substantial effects in family firms\(^\text{74}\).

There is no shortage of examples when it comes to family businesses that have faced governance challenges despite operating in environments that have a seemingly exhaustive corporate governance framework. In Kenya, the upheaval recently experienced by the retail sector in particular has been illustrative of the corporate governance challenges that plague Family Companies as will be seen below.


\(^{73}\) Bennedsen, Lez, Wolfenzon (n 49) 378

\(^{74}\) Ibid
2.4.1. **Naivas Supermarkets**

Mr Peter Mukuha Kago, the pioneer of Naivas Supermarkets, one of the most successful retail chains in Kenya, died leaving sons who took control of the ownership and management of the business. The business ran fairly successfully until around 2013 when some of the sons proposed to sell a 51% stake in the chain to a South African retail chain, Massmart. One of the sons, Newton Kagiri Mukuha, immediately moved to court seeking to stop the sale on grounds that his siblings led by Simon Gachwe and David Kimani had excluded him from owning a piece of the retail store, which targets low income earners and is Kenya’s fourth largest supermarket. Mr Kagiri told the court that he contributed Sh. 20,000 in 1990 of the Sh100,000 seed capital that led to the establishment of Naivas Supermakets by their late father Peter Mukuha Kago. But Naivas, through its chairman Gachwe, said that Mr Kagiri was a stranger to the retail chain. In the remarkable ruling issued in *Succession Cause No. 92 Of 2011 In the Matter of the Estate Of Peter Mukuha Kago (Deceased)*, which quoted the parable of the rich man and his servants and compared Mr. Kagiri to the servant who hid his masters wealth instead of investing it, the court held that Mr. Kagiri had no interest, legal or equitable in Naivas Limited.

The lack of objectivity and clarity surrounding the ownership of Naivas Limited that led to the probate dispute seemed to be a direct result of the challenge of informality prevalent in many Kenyan Family Companies. The dispute may have been avoided if the company had adopted best practices associated with governance in Family Companies, such as a detailed and public succession plan, a comprehensive shareholders agreement and a family constitution.

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2.4.2. Tusker Mattresses Limited

Tusker Mattresses Limited was started in the 1980s by the late Joram Kamau. Joram ran a small shop called Magic Enterprises in Nakuru\textsuperscript{76} which has since grown into one of Kenya’s fastest rising retail chains with a reported annual turnover of more than Kshs. 30 billion in 2012\textsuperscript{77}. The company is now run by the children of the late founder.

Between 2012 and 2015 sibling rivalry threatened to bring the Kenyan Family Company to its knees. Amidst court cases alleging fraud (\textit{Miscellaneous Criminal Application No.429 of 2012}) and assault (\textit{Miscellaneous Civil Application 179 of 2012}) it became clear that a lack of transparency and appropriate governance structures were plaguing the so far successful family enterprise.

Recognising the unique challenges posed by the emotional attachment to family businesses, the High Court appointed a mediator in the case of \textit{Republic v Chief Magistrate Milimani & another Ex-parte Tusker mattresses Ltd & 3 others [2013]} \textit{eKLR}. Following a few months of mediation, the mediator’s report presented to the court pointed out that the dispute that arose in the company was caused by lack of a board charter and shareholders agreement, key tools of good corporate governance. He also recommended that the company considers the expansion of Tusky’s Board of Directors to include three or four non-family members on the basis of their qualifications and a competitively hired CEO\textsuperscript{78}.

In short, the company looked to good corporate governance as a solution to the warring siblings. In addition to issues raised by the court appointed mediator, Mr. Yusuf Mugweru, a party to the case also


claimed that there was no transparency and accountability in the management of the company, as a result of the lack of proper governance structures.

It is reported\(^7^9\) that the cosy environment created for the family directors in the company allowed for directors to have their private companies trade with Tusker Mattresses Limited. The lack of transparency and structure surrounding these arrangements resulted in claims by shareholders and fellow directors of fraud and siphoning of Company funds. The Institute of Certified Public Accountants and the Institute of Certifies Secretaries were also involved in the dispute as disgruntled family members threatened to report the Company’s professional consultants for misconduct. This illustrates the importance of addressing governance in Family Companies at the professional stakeholder levels as well. Chapter 3 of this study will identify the custodians of good corporate governance and their role in promoting good governance in Family Companies.

2.4.3. Nakumatt Holdings

Nakumatt Holdings, now under administration is a family firm that has seen better days. The firm was started in 1987 by Mangalal Shah, and was passed down to his son, the now infamous Atul Shah. In 2014, Nakumatt, then the biggest retailer within the East African region and valued at Kshs. 1 trillion, had an opportunity to list on the Nairobi Stock Exchange\(^8^0\). In an attempt to maintain family control, the firm, led by the founder’s son Atul Shah, opted not to list. Here we see the SEW Theory illustrated, where a Family Company made a strategic decision based on the prioritization of family control.

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\(^7^9\) Kimani (n 76)
In 2017, it was clear that the fast growth experienced by Nakumatt was unsupported by the requisite governance structure which resulted in low risk management levels within the firm. The Company began to struggle with humiliating evictions by landlords, complaints from unpaid staff and suppliers, and empty shelves. Eventually its creditors went to court to seek intervention in the case of Insolvency Cause 10 of 2017 Primrose Management Limited & 3 others v Nakumatt Holdings Limited & another [2018] eKLR.

While the verdict is still out on whether Nakumatt’s problems were caused by poor corporate governance, changing economic times, overzealous expansion or sabotage by shareholders, it is clear that their ‘familiness’ and perception of SEW influenced their business strategy and decisions. At the time of its collapse, the founder’s son Atul Shah was the managing director of the company with his nephews and sons in the management team.

**2.5.Conclusion**

The above are a few examples of how of the challenges faced by Family Companies that have played out in the Kenyan market. To avoid being accused of being morose, there must be mention of some of the Kenyan success stories such as Kenpoly Manufacturers Limited, a family company established in August 1977 which is presently being run by the founder’s son, the Ramco Group which was started in the 1940s by Rambhai Patel and is now in its third generation and First Chartered Securities (ICEA Lion and NIC Group) which was started in 1978 and is now a dominant player in the financial services industry.81

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The latter section of this chapter was dedicated to providing a snapshot of how various challenges and characteristics of Family Companies are evident in Kenya. The next chapter will focus on the regulatory framework within which these challenges arise. In the next chapter the author will seek to interrogate whether the existing framework is sufficient to address these governance challenges, and whether more can be done to ensure that Family Companies thrive.
CHAPTER THREE

CORPORATE GOVERNANCE AND FAMILY COMPANIES IN KENYA: A REVIEW OF THE REGULATORY FRAMEWORK

4.1. Introduction

This chapter discusses the existing Corporate Governance Regulatory Framework in Kenya in order to assess whether it is sufficient to protect the valuable identity of family owned companies and address the unique governance challenges faced by Family Companies. It looks at the treatment of Family Companies under the existing corporate governance regulatory framework, focussing on references to family relations and control within the applicable laws, regulations and codes.

4.2. Corporate Governance in Kenya

The growing interest in the topic of corporate governance is not simply academic. It also gives evidence for explanatory theories to enable the development of appropriate solutions to relevant practical problems. Indeed, corporate governance is not merely an academic pursuit but one that is crucial to the everyday operations of business as evidenced in the previous chapter. As such, corporate governance is a dynamic and relevant discipline and its everchanging practical nature can be seen from a review of the corporate governance framework in Kenya. Rules relating to corporate governance are usually mixed in nature: the basic rules are laid down in statutory instruments, usually company laws.

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82 Capasso (n 56) 5
This section of the study will highlight the corporate governance sphere in Kenya relevant to Family Companies, while focussing on the need to further amend some of the existing laws, regulations and codes that make up the corporate governance framework in Kenya to specifically address challenges faced by Kenyan Family Companies.

Corporate governance in Kenya has been the subject of extensive reform over the past few years. The passing of the new Companies Act in 2015 gave a breath of fresh air to the existing corporate law practices and replaced the outdated Companies Act CAP 486 which had commenced in January 1962.

The enactment of the Companies Act 2015, was accompanied by numerous industry reforms in the area of corporate governance. Various codes of corporate governance were introduced and issued to tackle corporate governance challenges faced in various sectors. Both the CMA and the Public Service Commission (PSC) issued codes of Corporate Governance in 2015, with the CMA issuing the Code of Corporate Governance for Issuers of Securities to the Public, and the PSC issuing the Code of Governance for State Owned Corporations (Mwongozo). The ICS also issued its Code for Corporate Governance in Private Companies in 2015. All these sought to provide fresh insight on the application of the Principles for Corporate Governance to various entities in different industries. These were in addition to existing guidelines on corporate governance such as the Principles for Corporate Governance in Kenya issued by the Kenya Centre for Governance in 1999, the Corporate Governance guidelines issued by the CBK, CMA and IRA for banks, issuers of securities and insurance companies respectively.

As can be deduced from the above-named codes, corporate governance is in itself highly complex as it must consider and adapt to numerous important relationships within organisations with uncertain
cause-effect influences on matters that range from survival to sustainability\textsuperscript{84}. While the extensive corporate governance framework in Kenya demonstrates this high level of complexity in various industries and sectors with the multiplicity of corporate governance codes, it has neglected to sufficiently address the complex needs of Family Companies, despite the governance challenges faced in Family Companies. None of the new codes implemented post the 2015 Companies Act dealt specifically with Family Companies or the governance challenges they face.

The importance of overcoming the governance challenges faced by Family Companies through respecting the key pillars of corporate governance has been Family Company forums\textsuperscript{85}. As concluded in previous chapters, the challenges faced by Family Companies mainly relate to: (i) informality in the operations of Family Companies, (ii) lack of key structures to address the unique structure of Family Companies and (iii) lack of transparency particularly around individual rights and related party transactions. The latter challenge can be addressed through respecting the key pillars of transparency and accountability, while adoption of appropriate oversight structures and appropriate governance tools could eliminate the first two.

To analyse the inadequacy of the existing corporate governance framework in Kenya in addressing these issues therefore, the next paragraphs will be dedicated to reviewing the provisions of the aforementioned existing laws, regulations and codes in light of Oversight Structures, Transparency and Accountability and provision of Corporate Governance Tools.

**4.3. Constitution of Kenya**

\textsuperscript{84} Todd (n 53) 60
The Constitution of Kenya 2010 is the highest law within the Republic of Kenya. It is therefore not surprising that it recognises the family unit and iterates its paramount importance in society. While the Constitution does not specifically deal with the governance of family companies, it does set out the following guiding principles which apply to subsequent regulation of family matters:

a. the Preamble of the Constitution notes the commitment by the Kenyan people to nurture and protect the well-being of the individual, the family, communities and the nation. This would mean that the regulation of corporate governance in Family Companies should be designed to nurture and protect the family interests;

b. Article 31 of the Constitution notes that every person’s right to privacy, extends to the right not to have information relating to their family or private affairs unnecessarily required or revealed. Provisions on disclosure in Family Companies should respect these rights; and

c. Article 45, which is pertinent to all discussions on matters family, states that “the family is the natural and fundamental unit of society and the necessary basis of social order, and shall enjoy the recognition and protection of the State”. This creates a basis for the need for the law, regulations and various codes to protect the interests of the family, even within the corporate governance sphere.

On matters governance the Constitution clearly underscores the importance of good governance, transparency and accountability by including them in the national values and principles of governance. These national values bind all state organs, state officers, public officers and all persons whenever any of them enacts, applies or interprets any law; or makes or implements public policy

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decisions87. Therefore, any code, regulation or guideline that seeks to apply to Family Companies would need to embody these national values.

4.4. Companies Act

The Companies Act, 2015 was widely anticipated as its predecessor, the Companies Act Cap 486 came into force in 1962 and was viewed as having many gaps and being outdated88. It was enacted “to facilitate commerce, industry and other socio-economic activities by enabling one or more natural persons to incorporate as entities with perpetual succession, with or without limited liability, and to provide for the regulation of those entities in the public interest, and in particular in the interests of their members and creditors.”89

This section commences a discussion on whether the Companies Act, 2015 fulfils its objective by adequately providing for the regulation of Family Companies in the interests of its most important members - the family.

4.4.1. Oversight structures under the Companies Act

In Kenya, the oversight role in the Company is played by the directors of a company. This is also true in Family Companies where members of the Family appoint persons to the Board to oversee the operations of the Company on their behalf. This is an illustration of the form of agency proposed in the Agency Theory. Where the oversight role is played by a singular board of directors, an entity or regime is said to have adopted a one-tier system90. The Companies Act exemplifies the one tier board

87 Ibid
89 Companies Act 2015 LOK s 2
90 This is in contrast to the two-tier systems that have two levels of oversight e.g. an Executive/Management Board and a Supervisory Board.
system that Kenya has adopted. The Companies Act requires that all companies must have at least one natural person as a director while public companies must have at least two Directors\(^9\).

The duties, responsibilities and powers of company directors are provided for in Part IX of the Companies Act. Consumers of the Companies Act will note that the powers of directors under Kenyan law are far reaching. Further the powers of Directors are not limited to those listed in the Companies Act. For example, in the case of \textit{J.S.K (cargo) Ltd v. Kenya Airways Ltd}\(^{92}\) the court held that a director is the principal officer of a corporation who may speak on behalf of the corporation, a power not specifically mentioned in the Companies Act.

The interplay between oversight structures and the unique element of ‘familiness’ in Family Companies within the Companies Act is not clearly elucidated. When it does appear, it seems to only deal with instances of the impact of ‘familiness’ on control and conflict of interest. The first section of Part IX (Company Directors) for instance deals with persons connected with directors and includes the members of a director’s family as connected persons. The definition of family here is wide and includes spouses, children, parents, siblings, in-laws and grandchildren\(^{93}\). It is worth noting that the definition of connected persons does not include any such persons who are themselves a director of the company\(^{94}\). This would seem to imply that the impact of family relations is not material between members of the board, a direct contradiction to the RBV Theories and SEW theories which show that the family relations between members of the board continue to influence how the organization is run.

The Companies Act painstakingly defines persons connected to a director to enable readers to understand where a director is deemed to have control over a corporate entity. In instances where the

\(^{91}\) Companies Act 2015 LOK s 128 and 129,
\(^{92}\) [2008] eKLR
\(^{93}\) Companies Act 2015 LOK, s 122 and 123
\(^{94}\) Companies Act 2015 LOK s 122 (2)
directors and the persons connected to him own have interest in more than 50% of the share capital of a corporate body; or are entitled to exercise or control the exercise of more than fifty percent of the voting power at any general meeting of that body; they are deemed to control that corporate body.

By definition, Family Companies fall into the category of controlled companies. The Act does not go any further to identify challenges posed by such control or the attendant remedies. Yet it is this very aspect of control that creates the governance challenges present in Family Companies and the need for checks and balances to ensure that the adverse effects of family control are mitigated.

An important component of company oversight is the roles and duties of directors set out in the Act. For many years, the position as far as corporate governance in Kenya and in particular where directors’ duties were concerned, directors duties were provided by common law rules as well as equitable principles. The Companies Act, 2015 codified the duties and responsibilities of directors which include: the duty of a director to act within their powers as provided in the law and articles of association of the company, to promote the success of the company, to exercise independent judgement, to exercise reasonable care, skill and diligence in carrying out their mandate, to avoid conflicts of interest, not to accept benefits from third parties and to declare interest in existing transactions or arrangements.

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95 Companies Act 2015 LOK, s 125
96 Brenda Kosgei, ‘Assessing whether codification of directors’ fiduciary duties will facilitate at least partly improved corporate governance in Kenya: A critical analysis of the duty to promote the success of the company’ (LLB Thesis, Strathmore School 2017) 2
97 Companies Act 2015 LOK, s 142
98 ibid s 143
99 ibid s 144
100 ibid s 145
101 ibid s 146
102 ibid 147
103 ibid s 151
On the face of it these duties are compatible with the general principles of corporate governance given that they seek to enhance independence, transparency and accountability at the board level. However, the application of the principles of corporate governance are not a one size fits all glove. For example, the Companies Act provides that directors are required to avoid a situation in which the director has an interest that conflicts, or may conflict, with the interests of the company which includes situations where the director or member or their family member is a party to a proposed transaction or has material financial interest in the transaction\textsuperscript{104}. This touches on the conflict that is present in every decision of Family Companies where the board is comprised of family members. It would not be practical to require family board members to avoid such conflict as the mere fact that they and their family are shareholders creates conflicting interests. Granted, the Act provides that the duty to avoid conflict of interest is not violated where the directors authorise an action\textsuperscript{105}, and therefore gives a way out in situations where the conflict of interest cannot be avoided.

The conflict of interest that seems to be so frowned upon under the Companies Act often stems from the innate ‘familiness’ of Family Companies which gives them their competitive advantage, in that they are more likely to allow their conflicting interests e.g. protection of the family’s legacy/reputation to guide their strategies, oftentimes resulting in long term success. As highlighted in Chapter 2 above, owners of Family Companies often think in generational terms – they take long-term perspectives and make decisions based on sustainable economic value rather than short term earnings\textsuperscript{106}.

The Act therefore does not aid the exploitation of a Family Companies unique advantages in the oversight structures it creates which prevents the maximization of a family firm’s ‘familiness’. Family

\textsuperscript{104} Companies Act 2015 LOK, s 146
\textsuperscript{105} Companies Act 2015 LOK, s 146 (3) and (4)
Companies and family connections are not acknowledged, and where they are, they appear to be avoided and in the best-case scenario, tolerated.

4.4.2. Transparency and Accountability under the Companies Act

The Companies Act requires directors to disclose to the Board instances where they have an interest in any transaction with the company and if the company is public, such disclosure must be made to the shareholders of the company\(^{107}\). Except in the case of a liquidation and listed companies, transfers and acquisitions of assets between a company and its directors now call for members approval as well as any loans to directors in excess of Kshs. 1 Million\(^{108}\).

In addition to this codification of the principles of transparency and accountability, the Companies Act zeroes in on the long-term employment of directors and requires approval from shareholders where any long-term service contract is entered into with a director with a term of more than two years\(^{109}\).

This provides a system of checks and balances which would address some of the key information challenges found in family companies where the family members who are directors ostensibly use their powers within the family for their individual benefits as was alleged in *Republic v Chief Magistrate Milimani & another Ex-parte Tusker mattresses Ltd & 3 others [2013] eKLR*.

Another way transparency was introduced is the requirement for disclosure of director’s remuneration and benefits under the Act’s provisions on company accounting records and financial statements. Many of these however do not apply to companies under the small companies’ regime\(^{110}\).

\(^{107}\) Companies Act 2015 LOK, s 151

\(^{108}\) Companies Act 2015 LOK, s 158, 160, 161, 164, 167, 172

\(^{109}\) Companies Act 2015 LOK, s 157

\(^{110}\) Companies Act 2015 LOK, s 624: Defined in Section 624 as Companies (i) that do not have a turnover of more than fifty million shillings; (ii) whose net assets are not more than twenty million shillings; and that do not have more than fifty employees.
The enforcement of laws and regulations is regarded as a central issue of corporate governance\textsuperscript{111}. However, the law in the books needs to be moved into the law in action. Family Companies need to be equipped with the necessary tools through which they can comply with these disclosure requirements. While the disclosure requirements in the Companies Act do promote transparency and disclosure, many of them deal solely with large companies and a lot more awareness needs to be done to ensure that Family Companies are implementing these provisions.

The above provisions dealing with transparency and accountability deal with investors’ rights to information and protection of shareholders from insiders who could use Related Party Transactions (RPTs) to extract value from the company.

Other shareholder protections in place under the Companies Act that family members can take advantage of include: a right to participate in general meetings, a right to vote for and remove directors\textsuperscript{112}, a right to authorize changes to a company’s constitutive documents and a right to approve dividends. The extensive provisions on derivative actions in Part XI of the Companies Act also afford shareholders protection in cases where there has been negligence, default, breach of duty or breach of trust by a director of the company\textsuperscript{113}.

4.4.3. Corporate Governance Tools

Corporate governance tools are used to learn, implement or evaluate a Company’s corporate governance activities. They include: checklist and matrixes, handbooks, evaluation forms and sample reporting documentation. While the Companies Act has made great strides in codifying principles of governance that were previously left out of statute, it did not introduce any new corporate governance

\textsuperscript{111} Ruparelia and Njuguna (n 30) 158
\textsuperscript{112} Companies Act LOK, s 130 (Appointment) and 139 (Removal)
\textsuperscript{113} Companies Act LOK, s 238,
tools for use by companies. It has however, enhanced the financial reporting disclosure requirements of larger companies e.g. requirement to provide a director’s remuneration report which improves transparency and accountability. Indeed, many of the changes relating to transparency and disclosure introduced by the Companies Act 2015 catered to public and large companies.

4.5. Corporate Governance Codes and Regulations in Regulated Industries

Industry regulators in Kenya, including but not limited to, CBK, CMA, IRA, NSE, RBA and SASRA are all involved in setting out corporate governance guidelines for companies within their industry to adhere to in order to fulfil their regulatory mandate.\(^\text{114}\)

Section 33(4) of the Banking Act, empowers the CBK to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system. In this respect, the CBK has issued a Guideline on Corporate Governance which applies to all institutions licensed under the Banking Act\(^\text{115}\) (The CBK Guidelines).

The Corporate Governance Guidelines for Insurers and Reinsurance Companies were issued by the IRA in June 2011 with an aim of enhancing good governance practice by insurers which is viewed as critical to the insurance industry\(^\text{116}\) (The IRA Guidelines).

The CMA has propagated numerous regulations to improve the corporate governance of companies within the capital markets industry in line with its mandate to prescribe notices or guidelines on corporate governance of a company whose securities have been issued to the public\(^\text{117}\). These include


\(^{115}\) Banking Act Cap 488 LOK

\(^{116}\) Insurance Regulatory Authority Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011, g 2.0

\(^{117}\) Capital Markets Act Cap 485A s 11 (3) (v)
the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 and the Capital Markets (Corporate Governance) (Market Intermediaries\textsuperscript{118}) Regulations 2011, the ‘CMA Code’ and the ‘CMA Regulations’ respectively.

Family companies are generally excluded from the ambit of the above regulations due to the regulatory shareholding restrictions that disqualify them from operating in the above industries as family companies. However, some companies have found ways to maintain a significant level of control even within the restricted shareholding requirements. The Ndegwa Family for example, through the aforementioned First Chartered Securities, maintains a controlling interest in licensed insurance and banking institutions. As a result of operating in regulated industries, the Ndegwa Family is one of the most well-known families that have managed to maintain good corporate governance practices within their Family Companies in Kenya.

The provisions relating to Oversight Structures, Transparency and Accountability and Corporate Governance tools within these industries are briefly highlighted below to allow for an appreciation of the ways in which Codes and Guidelines in Kenya deal with the corporate governance challenges present in Family Companies.

\textbf{4.5.1. Oversight Structures in Regulated Industries}

The CBK Guidelines acknowledge that a company’s board is the primary structure charged with company oversight and maintains that the board shall be responsible for formulating policies, procedures and guidelines, which ensure that decisions are made in accordance with prudent banking practices. The CBK Guidelines also provide for the composition of the board of directors within banks,

\textsuperscript{118} Capital Markets Act Cap 485A s 23: Market intermediaries are defined as stockbrokers, derivatives brokers, REIT managers, trustees, dealers, investment advisers, fund managers, investment banks, central depositories, authorized securities dealers, authorized depositories, online forex brokers, commodity dealers and commodity brokers.
stating clearly that all licensed institutions, are to have at least five directors, at least three-fifths of whom should be non-executive directors. It is also required that independent directors should constitute not less than a third (1/3) of the total members of the board.

The IRA Guidelines define corporate governance as ‘the manner in which Boards of Directors and Senior Management oversee the Insurers’ business’. The guidelines go on to provide for the governance structure of the board, the roles and responsibilities of the board and the selection criteria for the board. This creates an effective corporate governance framework for insurers licensed to carry out insurance business.

The CMA Regulations provide for the composition of boards of market intermediaries. Notably, they expressly prohibit the boards from having more than one third of the directors as close relations, which implies that family influence and control should be avoided in order to maintain good corporate governance.

The CMA Code applies to both listed and unlisted public companies in Kenya. Therefore, any public family owned company that has issued a section of its shares to the public is expected to comply with the code on a comply or explain basis. The Code cites the board of directors as the ‘single most important institution in corporate governance’. It provides extensive recommendations for the

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119 Central Bank of Kenya Prudential Guidelines on Corporate Governance 2013, CBK/PG/02 Corporate Governance, g 3.2.2.1
120 Insurance Regulatory Authority Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011, g 3.1
121 Insurance Regulatory Authority Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011, g 3.2
122 Insurance Regulatory Authority Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011, g 3.3
123 Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011, r 3
structure and composition of the boards of listed companies including providing for the appointment, composition, size and qualifications of board members.

The provisions dealing with Company oversight in regulated entities set an example of ways to deal with the informality present in Family Companies. Due to their prevalence Family Companies should borrow from regulated industries and have guidelines, a sample code of governance or even a handbook to provide for the role, duties and composition of the board.

4.5.2. *Transparency and Accountability in Regulated Industries*

The IRA Guidelines demonstrate the widespread influence of the Stakeholders Theory as they recognize that ‘disclosure of reliable and timely information facilitates the understanding by prospective and existing stakeholders of … insurers and the risks to which they are subject, regardless of whether they are publicly traded or not’\(^{124}\). The primacy of stakeholders is further enshrined in the provisions in the guideline that require relevant, timely, comprehensive, reliable and consistent disclosures by insurers to stakeholders.

The CMA Code emphasizes that transparent and effective communication is important for building and maintaining trust that results in good relationships with stakeholders\(^ {125}\). In addition to the extensive disclosures for listed companies as set out in the Capital Markets (Securities) (Public Offers Listing and Disclosures) Regulations 2002 (Amended 2016), the Code advocates for proactive information dissemination by the Board of public companies to its stakeholders.

The same model should be adopted in any code or guidelines that apply to Family Companies.

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\(^{124}\) IRA Corporate Governance Guidelines for Insurers and Reinsurance Companies 2011, g 8.0

\(^{125}\) CMA Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, g 4.2.1.
4.5.3. **Corporate Governance Tools in Regulated Industries**

The sector specific guidelines, codes and regulations provide a myriad of corporate governance tools to guide institutions in implementing the principles of corporate governance. The CBK Guidelines provide forms to assess the competency of directors prior to appointment, and provide a prescribed Code of Conduct for the board of licenced institutions.

The CMA Regulations provide a prescribed Code of Conduct for market intermediaries. This code applies to market intermediaries to the extent that their codes omit or are inconsistent with its provisions. The CMA Regulations go a step further to require the boards of market intermediaries to develop a board charter to enable the effective discharge of their duties\(^{126}\) and to develop a policy for the appointment of employees, approved by the Authority. The mention of a policy for the appointment of employees is important to note because it is one of the major tools recommended for good governance in Family Companies. Unfortunately, even where this policy is in place it usually comprises a few standard statements on the company’s recruitment policies as opposed to the detailed policy necessary to address the governance challenges arising from the employment of family members in Family Companies.

The CMA Code provides for the annual governance audit as a tool to be used by public companies to check on the level of their compliance with sound governance practices\(^{127}\). The CMA has also published on its website a corporate governance reporting template to enable to disclose the extent of the application of the CMA Code\(^{128}\).

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\(^{126}\) Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011, r 10
\(^{127}\) CMA Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, g 2.11
As can be seen above, various industry regulators and corporate governance custodians in Kenya have provided the necessary guidelines, codes and tools to enhance corporate governance, and a majority of these are industry specific.

Where a family owned company falls within a regulated industry, they can be said to be well equipped with the tools for ensuring good corporate governance practices within their firm tailored to their respective industries. This could possibly be why some of the more successful family companies can be found in the financial services industries, such the Nyachae, Ndegwa and Kenyatta Families which have interests in insurance, asset management and banking.

However, Family Companies that fall outside these industries and the purview of regulators are not adequately covered. This creates a lacuna in the corporate governance framework as an estimated two thirds of all businesses, regulated or not, are Family Companies. This is concerning as these companies make up a majority of the companies and impact the society on a large scale.

4.6. Codes of Governance for Private Companies

There are only two codes of governance that can be said to apply to unregulated private Companies in Kenya, that is the Principles for Corporate Governance in Kenya and Sample Code of Best Practice for Corporate Governance prepared by the PSCGT in 1999 (‘Sample Code’), and the Code of Governance for Private Organizations in Kenya issued by the ICS in 2014 (“Private Companies Code”).

The PSCGT prepared the Sample Code and circulated the same as a guideline for corporate governance in Kenya. The Sample Code is preceded by a detailed background on corporate governance and the principles of corporate governance which were developed in consultation with
leading organisations with specific interest in corporate governance such as the NSE, CMA, ICPAK and the Kenya Chapter of the ACCA. It not only defines corporate governance as the manner in which the power of a corporation is exercised but also emphasizes that corporate governance promotes value creation. The Sample Code recognises that Kenya needs well-governed and managed business enterprises that can attract investments, create jobs and wealth and remain viable, sustainable and competitive in the global market place.

The Private Companies Code also recognises that good governance ensures sustainability of any business by generating long-term value for its shareholders and other stakeholders.

The next few paragraphs will look at how the provisions of these codes that deal with oversights structures, transparency and accountability and governance tools apply to Family Companies with a view to establish the sufficiency or insufficiency of the provisions in dealing with the challenges faced by Family Companies.

4.6.1. **Oversight Structures in Codes of Governance for Private Companies**

The Sample Code reiterates the responsibility that the board of a company has towards its stakeholders – which in a Family Company includes the family. It states that corporate governance creates value by ensuring that the Board has established mechanisms to guarantee that corporations operate within the objects established by shareholders, the mandate given to it by society, and meets the legitimate expectations of its various stakeholders.

Under the Sample Code, the board is to be comprised of a balance of executive and non-executive directors (including independent nonexecutive directors) such that no individual or group of

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129 PSCGT, Principles for Corporate Governance in Kenya and a Sample Code of Best Practice for Corporate Governance, (1999), Foreword
individuals or interests can dominate its decision taking. Yet again we see that the code seeks to eliminate control by a group of people, negatively implicating family control and locking out the competitive advantages that family owned companies would have by virtue of their control.

The Private Companies Code also recognises that the oversight function of a company is exercised by the Board. Its foreword expressly states that “Boards have a duty to be effective stewards and guardians of the organisation, not only in strategic direction and overseeing the conduct of business, but also …maintains an effective governance structure. It provides for the best practices in the appointment, composition and size of the board. Notably, it recommends that the chair of the Board be a non-executive director, and excludes the requirement for independence. To some extent this would be said to be in support of the maintenance of the “familiness” of Family Companies, as a family patriarch may be appointed as the chair regardless of their independence.

4.6.2. Transparency and Accountability

The Sample Code states that the tenets of corporate governance include accountability and transparency. Throughout the Sample Code the importance of accountability and transparency in organisations is evident. For instance the Sample Code recommends transparency and disclosure by providing that members of the corporation have a right to receive any information that would materially affect their membership, to participate in any meeting of members and to participate in the election of directors and be facilitated to fully participate in all other resolutions of interest to them as members. A more direct reference is included in the statement that an effective board should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve

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130 ICS, Code of Governance for Private Organizations in Kenya [2014]
131 PSCGT (n 129) 10
continuing prosperity and to act in the best interest of the enterprise in a manner based on transparency, accountability and responsibility.

The Sample Code places a large responsibility on the board to ensure transparency and accountability in their dealings and the organisations operations. According to the Sample Code, companies shall provide every director with a detailed manual covering the accountability of directors jointly and severally. Such a manual would indeed be useful in guiding the board members in Family Companies especially when it comes to their reporting to the family member shareholders within the firm.

The Private Companies Code deals with the principles of accountability and transparency separately in two extensive chapters. It covers financial reporting, risk management internal controls, procurement and information communication technology under the chapter on accountability, risk management and internal control. Interestingly, it recommends that the board of private companies should ensure that a business continuity plan is in place. The adoption of this practice by Kenyan Family Companies would solve many of the succession disputes that affect their governance. The chapter on Transparency and Disclosure in the Private Companies Code sets out the recommended practices in organization vision and values, corporate governance policies, governance structures, key stakeholders, board performance and remuneration, ethics and conduct as well as whistle blowing and financial reporting.

4.6.3. Corporate Governance Tools

The Sample Code provides several tools that can be used by companies to enhance their corporate governance. These include: a draft Board Evaluation Form, the Sample Code of Ethics, a Summary Form for Evaluation of Chairman of the Board and a Summary Form for Review of Individual
Directors Performance. While these are useful tools for private companies none of them specifically address the challenges faced by Family Owned Companies.

The Private Companies Code does not contain any corporate governance tools although mention of some of these tools in the code is prevalent, such as the recommendation to conduct a legal and governance audit, the emphasis on the need for a board charter and code of ethics etc.

Though Kenya has a wide ranging corporate governance framework as highlighted above, Family Companies remain unequipped to ensure good corporate governance is achieved in their operations. If one were to take the unlikely position that the framework that exists is sufficient, the next questions would be what causes Family Companies to continue having corporate governance challenges. A key consideration is the enforcement of codes. The enforcement and implementation of corporate governance regulation is tasked to various stakeholders. In Europe for example, investment bankers, consultants and lawyers in general will advocate compliance with the applicable governance codes132. Now that a comprehensive overview of the corporate governance framework in Kenya has been given above, the ensuing section of the study will briefly discuss the persons who are entrusted with ensuring this framework is applied.

4.7. Custodians of Corporate Governance in Kenya and Family Owned Companies

The custodians of corporate governance are not limited to industry regulators. In addition to the regulators identified in the preceding sections of this study such as the CBK, CMA and IRA, the

132 Wymeersch (n 83) 6
professional associations such as the ICS\textsuperscript{133} and ACCA\textsuperscript{134} also qualify as custodians who are to monitor and promote corporate governance in Kenya. Many audit firms for example have begun dedicating resources to Family Companies and departments are being set up to offer consultancy and professional services specifically to Family Companies within audit firms.

Private institutions have also been set up to enhance corporate governance in Kenya and these include the Centre for Corporate Governance (previously the Private Sector Corporate Governance Trust), a trust registered in 1999 to promote, co-ordinate and guide corporate governance in Kenya.

International bodies such as the OECD, the World Bank and the IFC have historically worked with government and non-government entities to promote corporate governance in Kenya and can therefore be classified as custodians of corporate governance in Kenya.

Save for the IFC whose approach will be discussed in detail in the following chapters, the custodians of corporate governance have not applied themselves to the corporate governance challenges in Family Companies. Indeed, where the codes and regulations issued by the custodians have touched on Family Companies, the implication is that family control should be avoided for a firm to be deemed to have good corporate governance.

However, Family Companies have not been left out of the picture entirely. The Association of Family Business Enterprises (AFBE) was founded in 2015 to strengthen the success of family businesses over generations\textsuperscript{135}. The association seeks to strengthen the governance, structures and succession planning

\textsuperscript{133} Established under Section 3 of the Certified Public Secretaries of Kenya Act, the mission of the ICS is to embed good governance practices that transform institutions and inspire professionals in order to be the premier centre of excellence in governance promotion and development in Africa. ICS Website <https://www.ics.ke/#about-us> accessed 15 October 2019

\textsuperscript{134} The ACCA’s mission includes supporting and promoting the highest ethical, governance and professional standards. ACCA Website <https://www.accaglobal.com/ca/en/about-us/our-mission-and-values.html> accessed 15 October 2019

\textsuperscript{135} AFBE, ‘About us’, <https://afbekenya.org/> accessed 2 June 2018
of family businesses\textsuperscript{136} which is a noble initiative given that the Family Business sector has been ignored for decades. As at the time this study was being conducted, the AFBE had set up a member’s forum and was organising conferences and seminars that provide support, advice and capacity building for its members. The AFBE is yet to issue any material specifically addressing corporate governance in family owned companies.

Academic institutions are also rising to the call of promoting good governance. Some institutions of higher learning have even gone as far as setting up entire departments dedicated to Family Companies and their growth such as Strathmore University which has developed a Family Business Program that offers training and coaching to Family Companies.

4.8. Conclusion

From the above, one can conclude that there exists a gap in the corporate governance regulatory framework, when it comes to Family Companies. Family Companies that fall under regulated sectors can be said to be catered for with the plentiful codes and regulations issued by regulators, however, these regulations seem to discourage Family Companies and do not protect the “familiness” within these entities. It is no wonder then that Family Companies in Kenya have grown in unregulated sectors such as manufacturing and retail sectors.

While it can be argued that the general codes for private companies discussed above can fill the niche for the need for corporate governance guidelines for Family Companies, the prevalence of governance challenges in Family Companies suggests otherwise. This points to the fact that Family Companies are unique in nature and require specific corporate governance standards. As Todd\textsuperscript{137} proposes: “new

\textsuperscript{136}AFBE, ‘What we do’, <https://afbekenya.org/what-we-do/> accessed 2 June 2018

\textsuperscript{137}Alex Todd ‘ICSA International: Corporate Governance Best Practices - One Size Does Not Fit All’ (2008) 60 (2) Keeping Good Companies 84
research reveals that corporate governance standards cannot be consistently applied to different structures; one size does not “fit all.”

In order for Family Companies to truly thrive and leverage their “familiness” they require their own set of guidelines, regulations and codes that address their unique corporate governance challenges. They also need to be recognised and adequately catered for within the existing regulatory framework.

In the next chapter we will see how both of these vital steps have been taken to promote corporate governance in Family Companies internationally.
CHAPTER FOUR

FOREIGN AND GLOBAL APPROACHES TO CORPORATE GOVERNANCE IN
FAMILY COMPANIES

4.1. Introduction

In the preceding chapter the corporate governance framework in Kenya and its position on governance in Family Companies in Kenya was established as wanting. It would be prudent to examine how corporate governance in Family Companies has been dealt with in other jurisdictions. This will aid in establishing the global best practices in corporate governance for Family Companies, and identifying ways in which the existing corporate governance framework can be revised, to improve the performance of one of the most prevalent form of business in Kenya.

Globally, a large portion of private companies are owned and controlled by their founders and families, especially in Asia and Latin America where some 95% of companies are family owned\(^\text{138}\). Globally Japanese family businesses have stood out as a result of their longevity – the oldest family business in the world is a Japanese hotel which has been owned and run by the same family since the year 718\(^\text{139}\).

In this chapter, the study will focus on the corporate governance practices set out in the Brazilian Code of Best Practices of Corporate Governance and the broad global practices recommended in the IFC

Family Governance Handbook. The Brazil jurisdiction was chosen as Brazil is considered the home of family-run firms, as Family Companies in Brazil represent 85% of all companies\textsuperscript{140}.

The IFC has acknowledged that Family Businesses can improve their longevity and sustainability by improving their corporate governance\textsuperscript{141}. In response to this, it has provided tools, consultations and training that focus on unique corporate governance challenges family businesses face and the practices that can mitigate these challenges. One of these tools is the IFC Family Business Governance Handbook. The IFC Handbook was identified as a source of global best corporate governance practices in Family Companies due to the global and practical approaches it provides, as the book was developed by the IFC to guide it in its investment in Family Companies across the world.

4.2. The Brazilian Code of Best Practices of Corporate Governance

As earlier indicated in this chapter, Brazil’s Family Companies are dominant both in the Brazilian market and internationally. Indeed, it is reported that the three largest non-government banks in Brazil are local-family businesses that are doing very well in the face of fierce competition from some of the world's largest banks, while the largest industrial conglomerate in the country, Votorantim\textsuperscript{142}, is fully owned by the founder's family, and is in the process of transition to the fourth generation\textsuperscript{143}.

\begin{footnotesize}
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\item \textsuperscript{141} ‘Family Business Governance’ <https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+CG/Topics/Family+Business+Governance> accessed 25 November 2019
\item \textsuperscript{142} IBGC, ‘Code of best practices of corporate governance’ (5th edn, IBGC 2016). Founded in 1918, Votorantim is controlled by the Ermírio de Moraes family. It was the master sponsor of the Brazilian Code of Governance.
\item \textsuperscript{143} Antonio C. Vidigal, ‘Family Business in Brazil’ <http://www.acvidigal.com.br/English/engacv/articles/engart6.htm> accessed 6 June 2019
\end{itemize}
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Kenya can learn a lot from Brazil, which has been categorized as an emerging market\textsuperscript{144}. Given the dominating percentages of family owned businesses in Brazil, it is no surprise that the Brazilian Code of Corporate Governance promotes structures that specifically address the governance challenges present in Family Companies.

The Brazilian Code of Best Practices of Corporate Governance, 5\textsuperscript{th} Edition (the Brazilian Code) was first issued by the Brazilian Institute of Corporate Governance (IBGC) in 1999 and has been revised severally, most recently in 2016\textsuperscript{145}. It is a harmonised document that seeks to extend its application to both private and public institutions. Its foreword states that “the word “organization” appears frequently…reflecting an effort to expand the document’s scope and make it more adaptable to other types of organizations, such as the third sector, cooperatives, state-owned enterprises (both fully owned by the state and mixed-capital enterprises), government agencies, and others”. The Brazilian Code was therefore developed to recommend best practices for a broad variety of organizations.

Despite the broad application of the practices set out in the Brazilian Code, there are 2 main practices prescribed that make it a distinctly “family friendly” code: the prescription for shareholder agreements seen in Section 1.5 of the Code and the listing of a Family Council as an oversight structure in Family Companies. While the study focuses on these two “family friendly prescriptions, the Brazilian Code has a lot more that Kenyan Codes can borrow from, such as the emphasis on ethics as being paramount to good corporate governance\textsuperscript{146} as well as the emphasis on the adoption of alternative dispute resolution measures such as negotiation, mediation and arbitration\textsuperscript{147}.

\textsuperscript{145} IBGC (n 142)
\textsuperscript{146} IBGC (n142) 18
\textsuperscript{147} IBGC (n142) Principle 1.4
4.2.1. Shareholder Agreements

The Brazilian Code anticipates that the articles of association of a company may not be sufficient to address the governance needs of organizations and goes a step above the Kenyan codes by providing for best practices on shareholders agreements. While some of the matters to be dealt with in the shareholders’ agreement could be covered by the articles of association, it may be preferable to include these provisions in the shareholders’ agreement as this is a confidential document – whereas the articles of association are available to the public. The Brazilian Code explains this principle by stating that shareholders’ agreements govern issues such as purchase and sale of shares by the signatories; preference to acquire shares owned by other shareholders; voting rights and controlling power at the general meetings.\(^{148}\)

In Family Companies, the shareholders agreement is a crucial document in setting out the agreement between the family owners on these matters. Many disputes which arise between shareholders can be avoided if an effective shareholders’ agreement is in place which deals with issues which can otherwise cause conflict.\(^{149}\) The shareholders agreement would enhance transparency and accountability within the Family Company, which, as seen in previous chapters would address the challenges of informality and lack of transparency.

The Brazilian Code limits the application of the shareholders agreement by stating that the interest of the organization cannot be placed at risk by an agreement between shareholders, and further providing that a shareholder’s agreement cannot contain limitations or restrictions to the powers and duties of the board of directors.

\(^{148}\) ibid
The Brazilian Code identifies the best practices around shareholders agreements as:

a. Accessibility: ensuring that the shareholders agreement is accessible to all the shareholders;

b. Conflict Resolution: ensuring a shareholder’s agreement contains sufficient provisions contemplating mechanisms for resolution of conflict of interest situations; and

c. Best Interests of the Company: providing that a board member elected under the shareholders’ agreement must deliver their votes with diligence and loyalty to the organization and not their nominating authority.

4.2.2. Family Council

The second “family friendly” practice set out in the Brazilian Code is the prescription for the establishment of a Family Council in Family Companies which is contained in Section 1.10 of the Brazilian Code. The Brazilian Code identifies the principle that the Family Council is the organ responsible for maintaining family-related matters separate from those of the organization, in order to prevent matters of exclusive interest to the family from interfering in the organization\textsuperscript{150}. This is a major step of recognition of how the “familiness” in a Family Owned Companies may affect its operations and governance as covered in earlier sections of this study. This is a fitting example of how corporate governance can acknowledge the unique nature of Family Companies and equip Family Companies with a means to maintain the same within a robust corporate governance framework.

\textsuperscript{150} IBGC (n142) Principle 1.10
The Brazilian Code identifies the best practices for a Family Council by prescribing that family-controlled organizations should consider creating a family council, which is defined as a group formed to discuss family matters and the alignment of its members’ expectations in relation to the organization\(^{151}\). The Code goes on to describe the duties and responsibilities of the Family Council which include:

a. defining the limits between family and organizations’ interests;
b. preserving family values (e.g. history, culture and shared vision) and treating the organization as a promoter of unity and continuity in the family;
c. defining succession, transmission of property and inheritance plans;
d. monitoring the preparation of the family members for succession within the organization, with regards to the vocational aspects, the career future and continuing education;
e. setting criteria for appointment of family members; and
f. as employees or administrators, where appropriate.

The recommendation for Family Companies to establish a Family Council within a Kenyan Code would be a major step in combatting the informality, lack of transparency and lack of adequate governance structures within Family Companies. The Brazilian Code acknowledges the truth that directors’ meetings and shareholders’ meetings are not appropriate forums for the discussion of family affairs; they need to focus on issues affecting the company and its business\(^{152}\). The Family Council is a crucial structure in the governance of Family Companies. Through things like a Family Council, family retreats, informal and candid discussions, and "newsletters," information is shared and questions answered that encourage "a sense of ownership," feelings of inclusion, and a continued,

\(^{151}\) IBGC (n142) Practice 1.10 (a)  
\(^{152}\) Tricker (n 138) 278
positive identification with "family."\textsuperscript{153} Kenya and its custodians of corporate governance could learn from the Brazil Code which embraces and provides for the most prevalent form of business in Brazil.

4.3. IFC Family Business Governance Handbook

The IFC Family Business Governance Handbook (the IFC Handbook) was issued by the IFC in 2008 to provide general guidance for investment by the IFC in Family Companies. It provides a concise and practical description of essential family business corporate governance components as well as suggested approaches to common family business governance dilemmas\textsuperscript{154}. The IFC Handbook covers the definition of Family Companies, highlights the challenges faced by Family Companies and then suggests practical solutions to address these challenges.

The IFC Handbook traces the growth of Family Companies from inception, and gives three main stages in the family business development cycle: The Founder Stage (Stage 1), The Sibling Partnership (Stage 2) and the Family Confederation (Stage 3)\textsuperscript{155}. The IFC Handbook identifies different governance challenges in each of these stages such as succession, teamwork and harmony, sustainability, allocation of corporate capital and conflict resolution. As a general principle, throughout the lifecycle of the Family Company, it is vital that the corporate governance framework adopted is appropriate to the stage of development\textsuperscript{156}. This is the approach used by the IFC Handbook in its governance recommendations.

\textsuperscript{153} Luis Eduardo Schio J., ‘Understanding the Family Businesses: A Case Study from Brazil’ (MSc Thesis, Massachusetts Institute of Technology June 2017) 118
\textsuperscript{154} IFC (n 22) 5
\textsuperscript{155} IFC (n 22) 16
\textsuperscript{156} Tricker (n 138) 277
The IFC Handbook advocates for a family governance structure that will bring discipline among family members, prevent potential conflicts and ensure the continuity of business. These are also objectives that any corporate governance regulation over Family Companies should aim to achieve. In Kenya, such family governance structures would greatly aid in mitigating the corporate governance challenges in Family Companies and may even aid in avoiding such challenges all together.

Some of the governance practices recommended by the IFC Handbook for application in Family Companies which Kenya could adopt in a similar handbook include:

a. The establishment of family governance institutions within family companies such as a family assembly, a family council and family office to manage the interplay between the affairs of the family and the business;

b. The adoption of a Family Constitution, as well as development and implementation of family member employment policies and family member shareholding policies to aid in transparency and accountability within the Family Company;

c. The inclusion of independent directors in boards. It is worth noting that the invitation of external independent directors is a practice that should be adopted with caution as it is likely to change the board culture because independent directors are not members of the family and inevitably ass a non-family dimension to discussions; and

d. The development of a formal senior management Succession Plan.

The main idea running throughout the IFC Handbook is that family member’s duty is not only limited to the governance of their company, but also to the governance of their family and that proper governance structures should be put in place to address this. This points to the IFCs recognition that

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157 IFC (n 22) 21
158 Tricker (n138) 277
Family Companies are unique and require their own set of governance structures – the handbook itself suggest that the standard governance practices applicable in other organizations are not sufficient to address the governance issues found in Family Companies.

In terms of governance tools, the IFC Handbook also contains sample policies that the IFC would recommend be developed within the Family Companies in which it invests based on actual case studies. In its recommendation for the adoptions of Family Member Employment Policies for example, the IFC Handbook gives the SABIS\textsuperscript{159} Family Employment Policy\textsuperscript{160} as a sample template to guide Family Companies in the development of their own Employment Policies. A similar approach should be adopted within the Kenyan corporate governance framework to ensure that Family Companies have access to the tools they need to achieve and maintain good corporate governance.

4.4. Conclusion

In the family-controlled company, the challenge remains to incorporate sound corporate governance practices that, on the one hand, ensure continuing professional management while, on the other hand preserve family unity\textsuperscript{161}. From the review of the Brazilian Code and the IFC Handbook, it is clear that this delicate balancing act has been addressed in other jurisdictions.

Further, it is evident that any code that applies to Family Companies should be tailored to address this balance. Unfortunately, the Kenyan codes and regulations reviewed in the preceding Chapter turn a blind eye to this balance. Given the growth of Family Companies in Kenya and the recent squabbles

\textsuperscript{159} Sabis is a family owned international college preparatory education system with a presence in 20 countries. It has recently opened a premise in Kenya. The first school was set up in 1886, and as of August 2007 the founding family comprised 25 members 10 of whom were working in the Family Business. \url{https://sabirunda.sabis.net/EN/the-world-of-sabis/about-sabis#Locator}

\textsuperscript{160} IFC (n 22) 24-27.

\textsuperscript{161} Tricker (n138) 278
that have been witnessed, Kenya should learn and borrow from the Brazilian Code and IFC Handbook to aid in a review of the Kenyan codes and regulations that apply to private companies to ensure that the governance needs of Family Companies are accommodated.
CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

4.1. Introduction

This Chapter summarizes the preceding chapters in order to give the reader a brief overview of the study. The key findings of the study as relates to the hypotheses advanced in the introduction will be emphasised. The final sections of this chapter will be dedicated to setting out the authors observations and proposed actions to be taken in respect of the gaps found in the current corporate governance framework.

4.2. Summary of Research Study

Chapter one of the study outlined the justification and objective of this study by highlighting the prevalence of Family Companies in Kenya and their impact on the society. Their impact on the society was the main justification for the examination of whether the corporate governance regulatory framework creates an environment that allows Family Companies to fulfil their stakeholder obligations without taking away from their unique character.

Chapter two built a conceptual framework for the study by highlighting the theory behind the definition of Family Companies, their unique characteristics and inherent value, as well as the unique corporate governance struggles they experience due to family control. The main challenges identified as being faced by Family Companies in Kenya included: informality in the business, lack of key governance structures to address their unique structure, lack of transparency within the Company particularly around individual rights and related party transactions, and a lack of adequate corporate governance tools to implement corporate governance principles within Family Companies.
The third chapter looked at the response of the Kenyan corporate governance framework to these challenges. Key legislation, comprising various provisions of the Constitution, Acts of Parliament, Regulations and Industry Guidelines were discussed, and it was found that the corporate governance framework as it is, is not conducive for family companies to maintain and exploit their identity. Further, the framework does not address the unique challenges found in Family Companies and does not provide the necessary tools to adequately equip Family Companies to carry out good corporate governance.

Chapter four looked at the international approach to Family Companies. A review of the Brazilian Code was carried out to identify the ways in which Family Companies have been appreciated within the Brazilian Corporate Governance Framework. This review covered the initiatives introduced by the Brazilian Code to address governance in Family Companies such as providing for best practices on Shareholder Agreements and Family Councils. The practical global approach to international best practices for Family Companies was then tackled by highlighting the provisions of the IFC Family Governance Handbook. This chapter concluded with the realisation that Corporate Governance in Family Companies has been effectively addressed in other jurisdictions and there is a need for Kenya to do the same.

4.3. Findings

This study commenced with three hypotheses, each of which has been dealt with extensively in this study. The next sections of this study will point out the findings of the preceding chapters with respect to each of the hypotheses identified in chapter one.

The first hypothesis proposed by this study is that Family Companies are important contributors to the Kenyan economy with a unique corporate character which gives them a competitive advantage that
should be protected. This hypothesis informs the need to study the application of corporate governance in family companies and further gives rise to a need for concern where there are challenges in Family Companies. Chapters 1 and 2 of this study found that Family Companies are important contributors to economies globally and Kenya is no exception, with a reported 75% of Kenya’s GDP being attributed to family businesses. The unique character of Family Companies was highlighted in Chapter 2 and supported by the application of traditional corporate governance theories (agency and stakeholder theory) and more modern sociological theories (RBV theory and SEW theory) to the governance of Family Companies. The competitive advantage created by these idiosyncrasies was emphasized in the latter theories as well. The hypothesis that Family Companies are important contributors to the Kenyan economy with a unique corporate character which gives them a competitive advantage that should be protected was therefore overwhelmingly proved.

The second hypothesis proposed in the opening chapter of this study was that the current corporate governance framework in Kenya does not adequately protect the unique nature of Family Companies and is inadequate to address their unique challenges. While looking at the unique nature of family companies, Chapter 2 of the study identified the corporate governance challenges faced by Kenyan Family Companies and found that these challenges were still prevalent despite the existence of an extensive corporate governance framework. Chapter 3 of this study examined the existing corporate governance framework in Kenya as relates to these challenges. The overall finding of these two chapters was in favour of the proposed hypothesis as it was found that there exists a gap in the Kenyan corporate governance framework to address the needs of Family Companies, particularly with regard to the necessary oversight structures and corporate governance tools.

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162 Ngunjiri (n 2)
The final hypothesis advanced by this study was that there exists a need for a review of the corporate governance framework as relates to private companies, coupled with the development of a comprehensive and detailed Code of Corporate Governance for Family Companies in Kenya. Following the above confirmation of the gaps identified in the existing corporate governance framework, this study found that there was a need to review the framework to cater to the needs of Family Companies. Chapter 4 which looked at the Brazilian Corporate Governance Code\textsuperscript{163} and the IFC Handbook\textsuperscript{164} confirmed that it was possible to provide oversight structures and governance tools specific to Family Companies and the challenges they face. This finding created the basis for the recommendations for a review of the Kenyan corporate governance framework which is detailed below.

4.4. Recommendations

Based on the above findings, and within the limitations of the study, the following are some of the recommendations that the author would like to make:

Firstly, there is a need for the recognition of Family Companies within the Kenyan Corporate Governance Framework. This requires that Family Companies be recognized by the agents and custodians of corporate governance as a dominant form of business with a unique character, worthy of the same attention given to major industries. This is because Family Companies form at least 60% of Companies in Kenya, and have far reaching influence on various industries, markets and groups of stakeholders. The retail industry is an example of an industry that is largely comprised of Family

\textsuperscript{163} IBGC (n 139)
\textsuperscript{164} IFC (n 22)
Companies that impact the daily lives of the Kenyan Public, which has been adversely impacted by poor corporate governance practices and a lack of adequate regulation. This increased recognition would lead to the development and documentation of best practices for Kenyan Family Companies, which is the following recommendation made by this study.

Secondly, given the findings in the previous sections of the study it would not be amiss to recommend that a regulatory framework that provides for the best practices of corporate governance in Kenyan Family Companies be developed. It would be prudent to develop a code of governance or governance handbook to address the unique corporate governance challenges faced by Family Companies, especially those that operate in unregulated industries. The Tuskys and Naivas cases highlighted in Chapter 2 demonstrate that there is a crucial need for guidance to be provided to Family Companies to enable them adopt international best practice in their corporate governance practices. Further, from an economic perspective, for economic growth to continue, African countries need to create competitive legal frameworks that continue to attract investors and protect their interests. A framework that promotes corporate governance in Family Companies, would create an attractive basis for investment in family companies.

Thirdly, in the development of the standards of best practices by any code or handbook should be accompanied by the development of appropriate corporate governance tools to assist in the governance of Family Companies in Kenya. The development and introduction of corporate governance tools into the corporate governance framework that are specifically tailored for Family Companies should be undertaken by the agents and custodians of corporate governance. The agents and custodians of corporate governance including the AFBE and their members, should work with their fellow

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institutions to develop these tools and should conduct awareness campaigns to market sample tools and templates. The model provided in the IFC Handbook\textsuperscript{166} and Sample Code\textsuperscript{167} where the import of each tool is discussed and a sample of each tool given should be adopted in this regard.

Finally, this study recommends that the existing Codes of Governance be reviewed with the aim of making them more “family friendly” needs to be undertaken. The Brazilian Code\textsuperscript{168} reviewed in Chapter 4 of this study demonstrates that it is possible to include provisions that foster good governance in family owned companies in codes of general application. The provisions in the Brazilian Code recognising the influence of Family Organizations as a prevalent form of business, essentially touching on shareholder agreements and Family Councils, should be adopted and applied to the Codes of Governance in Kenya, particularly those with general application to the private sector, namely the Code of Governance for Private organizations issued by the ICS\textsuperscript{169} and the Sample Code of Best Practice for Corporate Governance issued by the PSCGT\textsuperscript{170}.

As it is the current growth of Family Companies is not properly catered for in the Kenyan corporate governance framework and this leads them into governance standards that they are not aware of leading to a steep learning curve, or in worst case scenarios discourages them from growth entirely. This is becoming more and more evident as the first generation of the owners of Family Companies are passing on. Should the above recommendations be implemented, it would greatly improve the narrative of corporate governance in Family Companies and ensure that Family Companies are able

\textsuperscript{166} IFC (n 22)  
\textsuperscript{167} PSCGT (n 129)  
\textsuperscript{168} IBGC (n 142)  
\textsuperscript{169} ICS (n 130)  
\textsuperscript{170} PSCGT (n 129)
to comply with best corporate governance practices without losing their identity, or in worst case scenarios, their worth.

4.5. Conclusion

It is hoped that the above has provided readers with an appreciation of the important part played by Family Companies in the Kenyan Economy, and the importance of promoting healthy family businesses through the implementation of best practices in corporate governance for Family Companies. It is further hoped that this enhanced appreciation will sow a seed for reform within the corporate governance framework in Kenya to address some of the issues identified by this study. Further, once implemented, the recommendations advanced in the preceding paragraphs would also ensure that Family Companies are investor ready and enable them to be prepared for future growth.

In the course of the study, it has become apparent that there is a bounty of research areas within the study of Family Companies. Other areas identified for academics seeking to explore the interplay between Family Companies and the law would be Succession in Family Businesses, as well as Matrimonial Law and its application in the governance and operation of Family Business. The intersection between Employment Law and Family Companies recruitment policies, particularly provisions on discrimination would also be an area for further research on the basis that establishing a clear open-door policy that allows willing family members to be employed should be balanced with a performance-based promotion that is resolutely the same for both family and non-family managers.\textsuperscript{171}

\textsuperscript{171} Sir Adrian Cadbury (n 23)
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