CORPORATE GOVERNANCE PRACTICES IN HOUSING FINANCE COMPANY OF KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for examination in any other University.

Signature : J Date:

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This research project has been forwarded for examination with my approval as the University supervisor.

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DEDICATION

This study is dedicated to my wife Maureen Wanjiru for her love, support and encouragement during the entire duration of the course.

Further dedication is to my parents George Ngumi and Beatrice Njambi for their sacrifice to educate me and for teaching me the discipline and value of hard work.

I also dedicate this piece of work to my children; Sammy Njunji, Sylvia Njambi, Grace Wambura and George Ngumi. This piece of literature will be a source of motivation and desire for hard work when they become of age.

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Thank you all and may God bless you.

TABLE OF CONTENTS

ABREVIATIONS

BOD	- Board of Directors
CEO	- Chief Executive Officer
CMA	- Capital Markets Authority
CAGG	- Commonwealth Association for corporate governance
HFCK	- Housing Finance Company of Kenya
ICPAK	-Institute of Certified Public accountants of Kenya
IAS	- International Accounting Standards
IFRS	- International Financial Reporting Standards
ICGN	- International Corporate Governance Network
IFAC	- International Federation of Accountants
KBA	- Kenya Bankers Association
NYSE	- New York Stock Exchange
OECD	- Organisation for Economic Cooperation and Development
PSCGT	- Private Sector Corporate Governance Trust.
SEC	- USA security exchanges commission

ABSTRACT

Corporate governance is about putting in place the structure, processes and mechanisms by which business and affairs of the company or firm are directed and managed, in order to enhance long term shareholder value through accountability of managers and enhancing firm performance. In other words, through such structure, processes and mechanisms, the well-known agency problem - the separation of ownership (by shareholders) and control (by managers) which gives rise to conflict of interests within a firm may be addressed such that the interests of the managers are more aligned with those of shareholders.

The Organization for Economic Cooperation and Development (OECD), which in 1999 published its Principles of Corporate Governance, offers a more detailed, definition of corporate governance as the internal means by which corporations are operated and controlled, which involve a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company.

In the current and past century corporate lapses have been blamed on lack of good practice corporate governance. Globalisation has enlarged the operating business area of companies. Research on corporate governance has gained some momentum after several large companies collapsed around the world in the beginning of 2000s. These collapses were typically caused by accounting fraud and bribery among other things. Scandals had many effects to the governance practices in many companies, but also they accelerated the development of a legislation of corporate governance.

The study objective was to establish and explain the corporate governance practices in Housing Finance Company of Kenya. This objective was tested using a case study design. The findings from the study indicated that HFCK has good corporate governance practices as recommended by the various banking industry

stakeholders. The Board of HFCK is responsible for the overall management of the bank and is committed to ensuring that its business and operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices in corporate governance.

A study can be done in future on mapping the impact of corporate governance practices on the key business drivers of the company. A different research design can be used in future studies. A survey on corporate governance practices across the banking sector can be conducted. This will help to address the limitations of using case study methodology.

Further study can be carried out to determine the correlation between good governance and employee motivation at HFCK. The presence of employees makes it possible to have governance body separate from the management, which is a major pillar of corporate governance. Also a study can be conducted on whether there is any relationship between good corporate governance and good customer service. Nowadays one of the key business drivers is good customer service and hence the need to have this coming right from the governance level and therefore the need to test the relationship. Other studies on corporate governance could be done using other forms of research designs like a survey. This will illuminate the similarity of corporate governance practices across organisations and also help to inform the level of implementation of best practice corporate governance within and across sectors.

CHAPTER ONE INTRODUCTION

1.1 Background

1.1.1 Corporate Governance

Corporate governance has become a subject of heightened importance and attention in government policy circles, academia, and the popular press throughout the world. Various reasons explain the current prominence of what many persons might otherwise consider an arcane and technical topic. The recent financial scandals affecting major American firms, such as Enron, WorldCom, and Arthur Andersen, and the resulting loss of confidence by the investing public in the stock market have led to dramatic declines in share prices and substantial financial losses to millions of individual investors. Both the public and the experts have identified failed corporate governance as a principal cause of these scandals. Since half of all adults in the United States own stock either directly or indirectly, corporate governance reform has become a highly charged political issue. The American Congress rapidly responded by passing the Sarbanes-Oxley Act of 2002, which the New York Stock Exchange quickly followed by adopting sweeping new rules for listed corporations, thereby effecting the most significant reform in U. S. corporate governance since the creation of the country's securities regulation regime in the 1930's. Viewing the situation in the United States with alarm, European countries, mindful of earlier financial scandals of their own, are examining their own systems of corporate governance in an effort to guard against similar abuses (Currall and Epstein, 2003).

Cadbury (1992) defined corporate governance as the system by which companies are directed and controlled. Corporate governance is the way in which the affairs of the corporation are handled by corporate boards and officers. Hampbel (1998) observes that good governance ensures that constituents (stakeholders) with a relevant interest in the company's business are fully taken into account.

In broad terms, corporate governance refers to the processes by which organisations are directed, controlled and held accountable. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in organisations. Corporate governance is a concept that is currently receiving a great deal of attention worldwide in both private and public sectors (PSCGT, 2002). Recent developments have mainly been influenced by spectacular corporate collapses in the United States of America (USA) and Britain caused by fraud and mismanagement. There has also been repeated failure of the public sector in many countries of the world. Whereas most discussions have centred on public limited companies, corporate governance is a problem in all types of organisations.

Macey and O'Hara (2001) argued that commercial banks pose unique corporate governance problems for managers and regulators, as well as investors and depositors. They observe that the intellectual debate in corporate governance has focused on two very different issues; whether corporate governance should focus exclusively on protecting the interests of equity claimants in the corporation or whether corporate governance should instead expand its focus to deal with problems of other groups like stakeholders or non-stakeholder constituencies.

In addition, they state that the dominant model of corporate governance in law and economics is that the corporation is a "complex set of explicit and implicit contracts" meaning one should view the corporation as nothing than a set of contractual arrangements among the various claimants to the products and earnings generated by the business. The group of claimants include not only shareholders, but also creditors, employee-managers, the local communities in which the firm operates; suppliers and customers. They contend that in the case of banks, these claimants also include the regulators in their role as insurers of deposits and lenders of last resort and in their capacity as agents of other claimants.

It has become increasingly evident that our continued prosperity as nations, as communities, and even as dignified individuals, is closely linked with our ability to create, strengthen and maintain profitable, competitive and sustainable enterprises. The viable, competitive and sustainable modern enterprise requires an organization of basic resources (capital, material and human) concentrated in large aggregations giving the men and women entrusted to run those enterprises power over people, resources etc such that their decisions have great impact upon the society, the very lives of entire communities and can shape the future of nations. To achieve their objectives and effectively discharge their responsibilities, corporations must have quality and effective leadership which is responsive, transparent and accountable and which has the focused intelligence to acquire and apply knowledge and know-how for the production and creation of wealth. Good corporate governance is thus the lifeblood of a prosperous society. In targeting directors, corporate governance focuses on their competitive performance and the importance of their abiding by the highest standards of fiduciary management in order to assure wealth creation and the long-term sustainability of a company (Gatamah, 2005).

The collapse of big organisations has cast doubts in the way corporations are managed and made accountable. Enron, a Houston based energy trading company collapsed in early 2002 after reporting huge capital gains resulting from fraudulent accounting where billions of dollars were hidden in off balance sheet special purpose entities and partnerships (Kelly, 2002). WorldCom was the biggest carrier of internet traffic. WorldCom was caught hiding US$ 3.85 billion in expenses after failing to wring strong earnings after its merger with MCI. Corporate expenses were treated as capital investments allowing the company to show hefty profits in the year 2001 and for the first three months of 2002, rather than the losses it would have otherwise shown. The USA security exchanges commission (SEC) sued WorldCom for fraud. Its shares fell from an all time high of £64.5 to 83p after the fraud was made public (Newsweek, July 8, 2002)

1.1.2 Kenya's Banking Sector

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalised in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines.

The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and also addresses issues affecting its members. There are forty three banks and non-bank financial institutions, fifteen micro finance institutions and forty-eight foreign exchange bureaus. Thirty-five of the banks, most of which are small to medium sized, are locally-owned. The industry is dominated by a few large banks most of which are foreign-owned, though some are partially locally-owned. Six of the major banks are listed on the Nairobi Stock Exchange. HFCK is one of the listed non-bank financial institutions.

The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking. Key issues affecting the banking industry in Kenya are; changes in the regulatory framework, where liberalisation exists but the market still continues to be restrictive; declining interest margins due to customer pressure, leading to mergers and reorganisations; increased demand for non-traditional services including the automation of a large number of services and a move towards emphasis on the customer rather than the product; and introduction of non-traditional players, who now offer financial services products. The banking sector is poised for significant product and market development that should result in further consolidation of the banking sector.

In the late 1980s and early 1990s, corporate governance issues were low priority in the Kenya's banking sector. Directors were never vetted, shareholders could start banks almost at will, the role of the external auditors was not well defined, the prudential regulations were scanty and at some stage banks supervision did not play a major role in ensuring prudence in the financial sector. The effect was imprudent lending practices, excessive investment in fixed assets, inadequate systems to measure, identify and control risks. Subsequently, the Central Bank of Kenya undertook several measures to enhance corporate governance in the sector. The following measures were undertaken; introduction of an effective legal and regulatory framework, development of prudential regulations, increased interaction with other regulatory authorities, directors and external auditors, and amendment of the Banking Act.

All prudential regulations were also reviewed in the year 2000 and subsequently in 2005 to ensure enhanced corporate governance in the banking sector. Included in the revised prudential guidelines are; disclosure of the ten major shareholders of the company, requirement that no person should hold more than five directorship in any public listed companies at any one time, executive directors to have affixed service contract not exceeding five years with a provision for renewal, no person to hold more than two chairmanships in any public listed company at any one time and inclusion of a statement on corporate governance in the annual accounts.

In January 2002 the Capital Markets Authority while responding to the growing importance of corporate governance, issued a Gazette Notice spelling out the guidelines, adherence to which is mandatory to all public listed banks. The central bank has also gone a step further to request all banks including those that are not public quoted to include a statement on corporate governance in their annual accounts. The central bank is also committed to encouraging all financial institutions and especially the private ones to adopt the Capital markets Authority guidelines and Commonwealth principles on corporate governance.

1.1.3 Housing Finance Company

Housing Finance Company of Kenya was established in 1965 as a joint venture between the Commonwealth Development Corporation (CDC) and the Government of Kenya (GOK). HFCK is registered as a mortgage finance company with the main function of lending funds to the Kenyan public to enable them own their own homes.

HFCK is the largest mortgage financial institution in Kenya. It is headquartered in Nairobi and has branches in Mombasa, Nyeri, Nakuru, Kisumu, Eldoret and Thika. Initially CDC held 60% of equity while the Kenya government held 40%. By the year 2005 the government share holding had been reduced to 7%, CDC 24.9%, and the balance is owned by the public. In the year 2007 CDC sold its shareholding to Equity Bank Ltd(20%) and British American Insurance Co Ltd(4.9%). HFCK is quoted in the Nairobi Stock Exchange.

The Managing Director is in charge of the day to day management of the company. He is supported by divisional Directors who guide performance in five operating divisions namely, Business development, operations, human resources, credit risk and Finance division. The managing Director is responsible to the board for planning and implementing the company's policies. The responsibility of determining the direction of the company and carrying out the company's policies is vested in a board of directors comprising nine members.

The company is a registered mortgage company under the banking act (cap 488). Like other financial institutions in Kenya the company is under the supervision of the Central Bank of Kenya. The Central Bank of Kenya has various prescriptive guidelines issued to financial institutions to ensure prudent management of public resources. The guidelines include the prudential guidelines and risk management guidelines which also cover guidelines on good practice corporate governance.

1.2 Statement of the Problem

In the current and past century corporate lapses have been blamed on lack of good practice corporate governance. Globalization has enlarged the operating business area of companies. Research on corporate governance has gained some momentum after several large companies collapsed around the world in the beginning of 2000's. These collapses were typically caused by accounting fraud and bribery among other things. Scandals had many effects to the governance practices in many companies, but also they accelerated the development of a legislation of corporate governance. The importance of corporate governance lies in the power that is given to the people running the affairs of the organisation. In the recent times, this power has not always been used in the best interest of shareholders, employees or society in general. A World Bank review on corporate governance (1999) observes that major corporate failures are often the result of abuse of power and responsibilities and that only through an improved system of governance can an organisation address these issues.

According to Central Bank of Kenya (2002), corporate governance in the Kenyan banking sector largely relates to the responsibility conferred to and discharged by the various entities and persons responsible for and concerned with the prudent management of the financial sector. The corporate governance stakeholders in the Kenyan banking sector include the; the board of directors, the management, the shareholders, Central Bank of Kenya, external auditors and the Capital markets Authority. The customers and the general public also play a critical role in fostering corporate governance in the financial sector.

In the recent past, various studies on corporate governance have been done; Wang'ombe, (2003) Saccos in Nairobi, Mucuvi, (2002) Motor vehicle industry, Wainana, (2002) micro finance industry and Mwangi, (2001) Insurance industry. An expose by Prowse (1997) shows that research on corporate governance applied to financial intermediaries, more so banks is indeed scarce. This shortage is confirmed by Oman (2001); Goswami, (2001) and Arun and Turner (2002). They hold a consensus that although the subject of corporate governance in developing economies has recently received a lot of attention in the literature the corporate governance of banks in developing economies has been almost ignored by researchers, an idea shared by Caprio and Levine (2002). Macey and O'Hara (2001) shares the same opinion and adds that even in developed economies, the corporate governance of banks has only recently been discussed in the literature. Specifically none of these studies have reviewed corporate governance practices in the mortgage financing industry which is peculiar in its own way.

This study will attempt to answer the following pertinent questions emerging within the domain of the study problem; what factors influence corporate governance within HFCK and does HFCK corporate governance practices match good practice recommendations by world renown corporate governance regulatory organizations.

1.3 Objective of the Study

This study will establish and explain the corporate governance practices in Housing Finance Company of Kenya.

1.4 Importance of the Study

This study will provide an insight into the current corporate governance practices in the industry to stimulate research. To the academicians, this study will seek to improve the understanding of corporate governance in the banking sector and serve as a reference of governance at this point of time. A replica study can be carried out in future to find out the status of corporate governance.

To the society, the study will be a stimulant for stakeholders interested in enhancing their role in corporate governance. It will also contribute to the Company's management understanding of the concept and importance of good corporate governance.

The findings of this study can form the foundation of future studies on corporate governance. Future studies can be carried out using the survey methodology.

2.1 Corporate Governance

The term corporate governance appears to have arisen and entered into prominent usage in the mid-to-late 1970's in the United States in the wake of the Watergate scandal and the discovery that major American corporations had engaged in secret political contributions and corrupt payments abroad (Norman 1993). Eventually it also gained currency in Europe as a concept distinct from corporate management, company law or corporate organization.

Scholars and practitioners of corporate governance give the term a wide variety of definitions. Economists and social scientists tend to define it broadly as the institutions that influence how business corporations allocate resources and returns (O'Sullivan, 2001) and the organizations and rules that affect expectations about the exercise of control of resources in firms (World Bank, 2002). One noted economist has rather cryptically written that governance is an institutional framework in which the integrity of the transaction is decided (Williamson, 1996). These definitions focus not only on the formal rules and institutions of corporate governance, but also on the informal practices that evolve in the absence or weakness of formal rules. Moreover, they encompass not only the internal structure of the corporation but also its external environment, including capital and labor markets, bankruptcy systems, and government competition policies.

Corporate managers, investors, policy makers, and lawyers, on the other hand, tend to employ a more narrow definition. For them, corporate governance is the system of rules and institutions that determine the control and direction of the corporation and that define relations among the corporation's primary participants. The United Kingdom's 1992 Cadbury Report defined corporate governance as the system by which businesses are directed and controlled (Cadbury, 1992). As applied in practice, this narrower definition focuses almost exclusively on the internal structure and operation of the corporation's decision-making processes. It has been this narrower definition that has been central to public policy discussions about corporate governance in most countries; corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on investment (Shleifer and Vishny, 1997). It is the mechanisms that are used to "govern" managers to ensure that the actions they take are consistent with the interests of key stakeholder groups (Hill and Jones, 2001). The governance framework determines whom the organisation is there to serve and how the purposes and priorities of the organisation should be decided. It is concerned with both the functioning of the organisation and the distribution of power aiming at different stakeholders (Johnson and Scholes, 1997). In addition to shareholders, lots of other people are affected by the company and have a stake in how it behaves. The company ought to take its various interests into account alongside those of shareholders in all its activities. They can be regarded as investing in it each in their own way, whether through their capital, their work lives, their purchasing loyalty, or their local support and infrastructure.

The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining these objectives and monitoring performance (OECD, 1999).

In the Kenya Gazette Notice No.369 of 25th January 2002 corporate governance is defined as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realising shareholders long-term value while taking into account the interest of other stakeholders. It seeks to promote corporate fairness, transparency and accountability.

Broadly speaking, corporate governance generally refers to the processes by which organisations are directed, controlled and held accountable. It encompasses authority, stewardship, leadership, direction and control exercised in companies and corporations. Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the top of organisations (PSCGT, 2002). The bottom line is about power, how it's used and controlled.

In addition to the foregoing literature it is important to note that sound corporate governance practices and the need for greater transparency in the financial markets are vital to national economic welfare and is essential to maintain a stable economic environment (O'Sullivan, 2001). Mary notes that while such goals of financial transparency are pursued as much as possible in a coordinated manner, the corporate governance objectives are faced with stumbling blocks.

Standard agency theory of corporate governance, according to Shleifer and Vishny, (1997), focuses on the separation of ownership and control and investigates the mechanisms via which the suppliers of capital influence managerial decisions with varying degrees of success. Caprio and Levin (2002) developed this further by observing that small shareholders may seek to exert corporate governance by voting directly on major decisions, electing boards of directors, and signing incentive contracts with mangers that link pay to performance. Similarly, neutral debt holders may seek to constrain managerial discretion through covenants, such that default or violation of a covenant typically gives debt holders the right to repossess collateral, initiate bankruptcy proceedings and vote on removing managers.

In their discourse on concepts and international observations on corporate governance of banks Caprio and Levin (2002) have offered a conceptual framework for analysing corporate governance in banks. In this discourse, they observe that banks are particularly opaque (informational barriers) hence it is very difficult for outsiders to monitor and evaluate bank managers. This opaqueness makes it more difficult for diffuse equity and debt holders to write and enforce effective incentive contracts, to use their voting rights as a vehicle for influencing firm decisions, or to constrain managerial discretion through debt covenants. They argue further that government regulations frequently exacerbate corporate control problems in banks. Deposit insurance virtually eliminates any efforts by small depositors to monitor managers. Given that small depositors are unlikely to play a large corporate governance role even in the absence of deposit insurance, the more destructive effect of deposit insurance is that it reduces the need for banks to raise capital from large, uninsured investors who have the incentives to exert corporate control. Governments themselves are frequently the biggest problem as government regulators and supervisors typically have their own agendas that do not coincide with maximising bank value. Governments therefore, may directly hurt bank performance and stability by imposing their own preference on bank managers.

According to Caprio and Levine (2002), large informational barriers imply that outside bidders will neither have sufficient information to initiate a take over, nor will outsiders generate a sufficient takeover threat to limit managerial discretion. They argue that regulatory restrictions on entry and takeovers also reduce competition for corporate control in banking. Thus from many angles, they argue, the opaqueness of the banking industry along with pervasive government regulations severely limits effective corporate governance of banks.

In another discourse, Berth *et al* (2001) demonstrate that regulation and supervisory systems that foster more accurate information disclosure empower private investor's legal rights, and does not offer very generous deposit insurance substantially boost banking system performance and stability. Berth *et al* (2001) emphasize that competition among banks also do improve corporate governance within them. For example banking systems that permit foreign entry and that allow banks to compete along many dimensions enjoy higher levels of banking development and less banking sector fragility.

In a synopsis, the enhancement of information disclosure system, creation of incentives for private agents to monitor banks, and strengthening legal and bankruptcy systems will fundamentally improve the infrastructure of corporate governance.

2.2 Developments in Corporate Governance

The World Bank and the OECD established the global governance forum which was mandated to build a consensus in favour of coming up with an appropriate policy on regulatory and corporate reforms. It was also charged with a mandate to coordinate and disseminate corporate governance activities, provide corporate development and capacity building in the associated fields of corporate governance and train the various professionals and other agents essential to bringing about a culture of compliance.

The international corporate governance network (ICGN) was established also to promote and coordinate research and development in corporate governance. Also established was the Commonwealth Association for corporate governance (CAGG), which came up with the November 1999 commonwealth heads of government meeting in Durban South Africa as a guide for all commonwealth countries to develop or enhance their own national corporate governance principles.

In Africa, the Africa capital markets forum has been undertaking a study on the state of corporate governance in Africa. The King's committee report and code of corporate governance in South Africa published in 1994 continues to stimulate corporate governance debate in Africa.

In East Africa, regional conferences were held in Kampala, Uganda in June 1998 and September 1999 to create awareness and promote regional cooperation in matters of corporate governance. Uganda and Kenya have made considerable progress in formulating national codes of best practice corporate governance, while Tanzania is still at the formative stage. In Kenya the Private sector initiative for corporate governance is mandated to explore ways of facilitating the establishment of a national body to promote corporate governance in the country and to coordinate developments in the area of corporate governance in East Africa.

2.3 Principles of Good Corporate Governance

The Cadbury report (1992) identified the fundamental principles of corporate governance as openness, integrity and accountability. These principles are relevant to both private and public entities. The Cadbury's report defined the three principles in the context of the private sector and more specifically, of public companies. In the context of the public sector, these definitions need to be adapted to reflect the key characteristics of the public sector entities, which distinguish them from the private sector. In particular, public sector entities have to satisfy a more complex range of political, economic and social objectives, which subject them to a different set of external constraints and influences; and are subject to forms of accountability to their various stakeholders which are different to those that a company in the private sector owes to its stakeholders (IFAC, 2001)

The report of the Nolan Committee, published in May 1995, identified and defined seven general principles of conduct that should underpin public life. The committee recommended that all public sector entities should draw up codes of conduct incorporating these principles. The principles are selflessness, integrity, objectivity, accountability, openness, honesty and leadership.

Corporate governance seeks to find the appropriate mechanisms for governing the relationships of constituent groups with the organisation so as to generate long-term value. It reduces conflict of interest among stakeholders and makes sure that the right people make the decisions. It ensures that corporate power is exercised in the best interest of society. It also helps the aligning of responsibility and authority to be able to achieve optimum conditions for growth and success (PSCGT, 2002).

Effective corporate governance ensures that long term strategic objectives and plans are established and proper management and management structures are in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the company's integrity, reputation and accountability to its relevant constituencies. The right system of checks and balances should be the basis of merit for any corporate governance system (Hunger and Wheelen, 1996).

For corporations to be efficient and productive, they must apply good corporate governance practices that are framed on four pillars. First, there should be an effective body responsible for governance separate and independent of management to promote accountability, efficiency and effectiveness, probity and integrity, responsibility, transparency and open leadership. Secondly, there must be an all inclusive approach to governance that recognises and protects the rights of all members and all stakeholders. Thirdly, the corporation must be governed and managed in accordance with the mandate granted by the founders and the society, and they should take their wider responsibilities seriously in order to enhance sustainable prosperity. Finally, the corporate governance framework in the corporations should provide an enabling environment within which their human resources can contribute and bring to bear their full creative powers towards finding innovative solutions to shared problems (PSCGT, 2002).

2.4 Importance of Corporate Governance

Good corporate governance aims at the increased profitability and efficiency of business enterprises and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and increased benefits to stakeholders. The transparency, accountability and probity of business enterprises make them acceptable as caring, responsible, honest and legitimate wealth creating organs of society. The credibility of business enterprises enhances their capacity to attract investment in an internationally competitive environment. The enhanced legitimacy, responsibility and responsiveness of business enterprises within the economy and improved relationships with their various stakeholders comprising shareholders, managers, employees, customers, suppliers, host communities, providers of finance and the environment enhance their market standing, image and reputation (PSCGT, 2002).

Good corporate governance ensures the highest standards of corporate responsibility, citizenship and business ethics in an effort to strengthen mutual responsibility. It enhances the spirit of participatory development, create partnerships for progress and increase citizen engagement in establishing a secure and stable environment in which business enterprises can grow and thrive.

As far as the public sector is concerned, efficient use of resources and accountability strengthens the stewardship of these resources, improve management and service delivery, thereby contributing to improving peoples lives. Effective governance is essential for building confidence in public sector entities which is in itself necessary if they are to be effective in meeting their objectives (PSCGT, 2002).

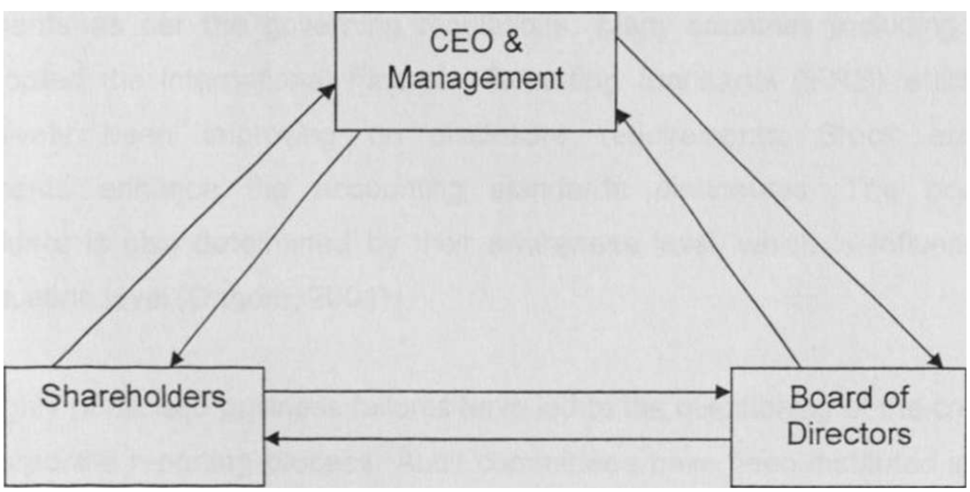
Progressive economic growth and social development over a prolonged period of time depends on decisions about allocation, utilisation and investment of resources. Strategic decisions about the allocation and utilisation of corporate resources are the foundations of investments in productive capacities that can make innovation and economic development possible. Corporate decisions on whether to invest, how soon to invest, what to produce and whether to employ ultimately affect income, employment needs and indeed livelihoods of the entire society (PSCGT, 2002).

The national capacity to compete in the borderless and liberalised global market increasingly depends on the competitiveness of individual corporations and their ability to produce highest quality of products and services that meet the test of international competition. A corporation's competitiveness depends on the ability of the board of directors to apply and generate innovative ideas, acquire and apply knowledge and know how to push and integrate their corporation into the competitive global market (Hunger and Wheelen, 1996). Strictly speaking, corporate governance is a matter of vital concern for all corporations, large or small, publicly traded or privately held

2.5 Corporate Governance Structure

Montgomery and Kaufman (2003) acknowledge that the corporate balance of power is delicate. The three principal actors in this power game are the shareholders, management and the board of directors as shown in figure 1. The interrelationship between them is key to effective governance and forms a triangular relationship.

Figure 1: The Corporate Governance Triangle



Source: Adapted from Montgomery and Kaufman." The Board missing link", Harvard Business Review, March 2003

2.5.1 Shareholders

Primarily it is the money raised from shareholders, known as capital, which is used by an organisation to finance its operations. They do not have direct right in the property of the organisation as a whole. They do not engage in daily management of the organisation. Instead, they elect persons known as directors, who collectively as a board represent them and oversee the management on their behalf. The shareholders control the long term direction of the organisation through the general meetings which in most type of organisations are held at least once a year. At the general meetings, they deliberate and vote on important issues such as election of directors and auditors. After appointing directors and auditors, they should satisfy themselves that an appropriate governance structure is in place. They are expected to remove directors if unhappy with their actions. They should evaluate the performance of directors regularly. For them to be able to do this, they need to be properly informed about the company's activities in order to carry our their evaluation (PSCGT, 2002).

One of the ways organisations report to their shareholders is through the annual audited reports. The reports are prepared with due regard to requisite disclosure requirements as per the governing regulations. Many countries including Kenya have adopted the International Financial Reporting Standards (IFRS) which have progressively been improving on disclosure requirements. Stock exchange requirements enhance the accounting standards disclosures. The power of shareholders is also determined by their awareness level, which is influenced by their education level (Ongore, 2001).

Some highly publicised business failures have led to the questioning of the credibility of the corporate reporting process. Audit committees have been instituted in many organisations to check on the accounting and reporting process. An audit committee usually consist of a majority of independent and non-executive directors. Important attributes of committee members should include broad business knowledge relevant to the company's business, keen awareness of the interests of the investing public, familiarity with basic accounting principles and objectivity in carrying out their mandate and no conflict of interest. The audit committee deals with the annual audit for reporting to outsiders as well as the internal audit. By playing a proactive role, audit committees can enhance credibility of financial reports and strengthen communication between auditors and management. This in turn improves the quality of information reported to the market and enables investors to make informed decisions (IFAC, 2001).

2.5.2 Board of Directors (BOD)

The BOD is the link between the people who provide capital (shareholders) and the people who use that capital to create value (management). Their primary role is to monitor and influence the performance of management on behalf of the shareholders in an informed way. Efficient corporations can only be established and developed by responsible, creative and innovative boards. Indeed, without efficient corporations, a country will not create and produce wealth fast enough or generate employment opportunities.

In a legal sense, the board is required to direct the affairs of the corporation but not to manage them, It is charged by law to act with due care (sometimes called due diligence). Directors must act with that degree of diligence, care and skill which ordinary prudent people would exercise under similar circumstances in like positions. If a director or the board as a whole fails to act with due care and as a result, the corporations is in some way harmed, the careless director or directors can be held personally liable for the harm done.

Hunger and Wheelen (1996) outlined three basic strategic management roles for boards. First, to monitor by acting through committees, staying abreast of developments both inside and outside the corporation. The board can thus bring to management's attention developments that management might have overlooked. At minimum, the board should carry out this task. Secondly, a board can examine management's proposals, decisions, and actions; agree or disagree with them; give advice and offer suggestions; and outline alternatives. More active boards do so in addition to monitoring management's activities. Thirdly, a board can delineate a corporation's mission and specify strategic options to its management. Only the most active boards take on this task in addition to the previous two.

The boards of most publicly owned companies are composed of both inside and outside directors who are officers or executives employed by the corporation. Some countries like Germany adopt a two-tier board system where there is an executive board and a supervisory board (IFAC, 2001).

Traditionally, the CEO of the company decided whom to invite to board membership and merely asked the shareholders for approval. The main criteria used by most CEOs' in nominating board members were that they be compatible with the CEO and that they bring some prestige to the board. The danger of such practise is that the CEO might select only board members who in the CEO's opinion, will not question or disturb the company's policies and operations. Moreover, directors selected by the CEO often feel that they should go along with any proposal made by the CEO. Those board members find themselves accountable to the very management they are charged to oversee. As a result, increasingly the tendency is for a special board committee to nominate new outside board members for election by shareholders (IFAC, 2001).

2.5.3 Management

These comprise the CEO and his senior management team. Their primary responsibility is performance. Top management and especially the CEO, is responsible to the board of directors for overall management of the company. Specific top management tasks vary from company to company and reflect an analysis of the mission, objectives, strategies and the key activities of the company (Johnson and Scholes, 1997). Generally, effective top managers are people who see the business as a whole, who can balance the present needs of the business against future needs, who can make sound timely decisions.

There is a tendency for top management to draw back to functional work. We can also have top managers perceiving only those aspects and responsibilities of their function that is compatible with their abilities, experience and temperaments as their role. If the board of directors fail to state explicitly what it considers to be the basic responsibilities and activities of top management, top managers are free to define their jobs themselves. Therefore important tasks can be overlooked until a crisis occurs (Johnson and Scholes, 1997).

The Federal republic of Germany pioneered the practice of including company workers on the board. However, the need to work for the company as a whole and at the same time represent the workers creates role conflict and stress among worker directors, thus reducing their effectiveness (Gareth and Charles, 2001). The CEO delegates responsibility for performance to the employees. As such, every employee needs to be accountable for his or her expected contribution towards the successful delivery of outputs. Ideally, the CEO should enter into performance contract with senor executive officers who should in turn enter into performance contracts with their subordinates. This would ensure that individual responsibility for management decisions is established and that individuals are accountable for their actions in the organisation (IFAC, 2001).

A fairly common practice especially in the USA was to have the chairman of the board also serve as CEO. However, the recent thinking is that CEO should not serve as Chairman because of the potential for role conflict. It is difficult for the board to oversee top management if the chairman is in top management. For this reason, law in Germany, the Netherlands and Finland separates the chairman and CEO roles. Similar laws are being considered in most countries of the world and the provision has already been included in regulatory authorities' guidelines like those by capital markets authorities in Kenya (CMA, 2002).

2.6 Features of the Board

The features of the board including composition, committees, size and structure should easily allow the board to carry out the various governance activities. However, the contribution of each of the features is largely dependent on the mode of adoption.

2.6.1 Composition

Boards have been defined as small formal groups composed of inside and outside directors. Theoretically, non executive directors, it has been suggested, have the potential of providing independence and objectivity in judgement. Conversely, executive directors usually display great insight and grasp of critical issues facing the company. Both can make significant contributions during board meetings, Patton and Baker (1987). There is almost consensus in favour of majority non-executive directors after all; the primary purpose of the board is to secure appraisal and independent check on senior management of the company. Cadbury (1992) recommends that at least one third of the board composition should go to non-executive directors.

2.6.2 Board Committees

Committees are drawn from the full board and hence are smaller than the full board, meet more frequently, and therefore can transact business much faster than the full board. The use of board committees facilitates performance or a more in-depth analysis of a particular matter than would otherwise be practicable for the entire board. Use of the executive committee for example, permits emergency action to be authorised between regular board meetings pending review and ratification by the full board.

An active committee structure is recommended particularly for the large boards while appointment to the committees should take cognisance of the individual talents, experience and expertise of the respective directors. In addition, a formal method of rotating the directors within the committees would be advisable. Committees are special task forces that are mandated to perform specific duties and include executive, finance, nomination, remuneration, supervisory and audit committees among others, Donaldson (1995).

2.6.3 Size of the Board

Salmon (1993), recommends that there is need for a balance between large and small boards, arguing that when membership goes beyond fifteen it turns into a crowd and will diffuse and cut into productive debate. He recommends that boards should be composed of eight to fifteen members, while Demb and Neubaauer (1993) suggest a range of eight to ten members.

Patton and Baker (1987), contend that large boards are less effective than small ones. But Demb and Neubauer (1993), are of the opinion that smaller boards more often than not transform into clubs with directors being unable to challenge their colleagues courtesy of the friendly atmosphere that eventually evolves and hence the need for a balance.

2.6.4 Structure

Structure has been defined as the style that governs the meetings of the boards, the choice being between the two-tier boards usually when within the board there are supervisory and executive committees and unitary boards, where the entire board meets as a single unit. According to Demb and Neubauer (1993), the unitary structure boards are more popular. This structure is however, not without limitations as it provides an ideal setting for domineering CEO to usurp board powers by withholding vital information from non-executives while, at the same time intimidating his fellow company officers. The two-tier structure on the other hand, sacrifices information dissemination while retaining a firm grip over management through the supervisory committee composed of non-executives, Demb and Neubauer (1993).

2.7 Corporate Governance Transformations

Scandals like the Enron have shown the importance of pursuing profits within ethical bounds and the danger of executives and shareholders enriching themselves by extorting the public or employees. Toothless codes of ethics like Enron's are no help. Ethical concerns must grow teeth, which mean biting into reform of corporate governance. While most proposals for reform today merely tinker at the margins, some get to the heart of the matter (Estes, 2002). A number of practices have come up to strengthen corporate governance.

In the wake of Enron, WorldCom and a chain of other scandals, USA no longer trusts its corporate leaders to tell the truth without being warned of prison doors slamming. In America, chief executives are swearing in front of a notary that "to the best of my knowledge", their latest annual and quarterly reports neither contain an "untrue statement" nor omit any "material fact". The oaths are only the first wave in a flood of new regulations enveloping companies in America (Kelly, 2002).

Stock exchanges in many countries of the world are coming up with rules aimed at restoring the quality of disclosures by preventing harmful conflicts that were evident in the most spectacular recent bankruptcies. The NYSE requires firms to get shareholders approval for all stock option plans. They must also have a majority of independent directors in their boards and only independent directors on the audit committees and the committees that select chief executives and determine pay. US companies are now prohibited from providing subsidised loans to executives and requires bosses to reimburse incentive based compensations if profits are found to have been misstated.

There are moves to ensure auditors really audit by making them fully independent. Auditors are not the tools of management. They are the eyes and ears of shareholders (who own the company) and no bonds or other deals should be put above the ownership of shareholders (without their permission). Instead of having companies as the "bosses" of their own auditors - selecting and paying the firms they want to work with- a corporate accountability commission could assign auditors and pay them for fees assessed on companies. The commission would be empowered to expend reporting requirements beyond stockholder needs to encompass data needed by other stakeholders such as pollution emissions, wages and benefits paid and corporate welfare received (Estes, 2002).

If we are tired of the boards with "no linking" of what's going on, we should seek directors who have a clue. If the problem is that CEOs will appoint cronies, make the board elections a real horse race: allow persons to self-nominate and run, being elected one by one, not as a slate. In short, get some real governance going (Kelly, 2002).

Unfortunately, few companies appear to truly appreciate the depth and complexity of this topic. Indeed, corporate governance reforms are often introduced superficially and used as a public relations exercise rather than as a tool to introduce the structures and process that enable the company to gain the trust of its shareholders, reduce vulnerability to financial crises, and increase the company's ability to access capital. Introducing internal structures and processes built on the principles of fairness, transparency, accountability, and responsibility is a difficult task that requires an ongoing commitment by the company. One of the key strategic thrusts of the New Partnership for Africa's Development (NEPAD) is the improvement of economic and corporate governance. The leaders have repeatedly underscored the importance of good corporate governance in the sustainable development of Africa (Gatamah, 2005).

CHAPTER THREE RESEARCH METHODOLOGY

3.1 Research Design

A case study research design was used. Both Young (1960) and Kothari (1990) concur that a case is a very powerful form of qualitative analysis that involves a careful and complete observation of a social unit; be that unit a person, a family, an institution, a cultural group or even the entire unit community. It is a method of study that drills down rather than casts wide. The research framework is of descriptive nature. A descriptive study is preferred to simple data as the researcher is able to investigate the relationship between two or more variables (Peterson, 1982).

3.2 Data Collection

Multiple sources of evidence were used in order to obtain sufficient information and provide reasonable reliability of the results. Data and evidence collection was based on the analysis of primary and secondary data. Using these sources together it was possible to collect complete and reliable information and to obtain a clear picture of the problem.

In order to gather primary information an interview guide was used. The interview guide assisted the respondents to structure their responses during the interview session. Interviews were held in semi-structured form using the questionnaire. The questionnaire contained both open ended and closed ended questions. Secondary sources of information included the company's annual report, central bank of Kenya disclosures, CMA and NSE reports filed by the company over a period of time.

Primary data was obtained in the form of interviews with two senior management members, (Director of Finance and Head of Internal Audit). This approach was chosen because of questions flexibility, easiness with which I could go in more depth, enabling to test the limit of the correspondent knowledge and allowing the interviewer to make a more reliable assessment of what respondent really believes.

3.3 Data Analysis

This study is descriptive and explanatory in nature. Content analysis method was used to analyse collected data. This method was chosen because of its strength in compressing lengthy interviews and conversations. Data was classified into various themes for ease of analysis. Through this method conclusions were made by systematically and objectively identifying specified characteristics of information collected. Content analysis categorises phrases, describe the logical structure of expressions and ascertain associations, connotations, denotations, elocutionary forces and other interpretations (Mugenda, 1999).

CHAPTER FOUR FINDINGS AND DISCUSSION

4.1 Board Composition

From the findings, it was found that the board had eight members out of whom two were women. One of the Directors resides in the UK and represents the board slot for CDC. All the board members were found to be non-executive employees of the company except the Managing Director. Skills represented at HFCK's board included; legal, banking, finance, insurance, audit, economics and business management. The respondents felt that they would like to see the skills of human resources and fundraising added to the board.

Members of the board are nominated and selected to the board by other members. The person must be of good standing in society, be known and acceptable to the current board members. Member's terms are set by the articles of the company. The Chairman of the board is nominated by the other members through consensus. The term of the chairman is renewable after three years.

4.2 Strategic Functions of the Board

The Board recognizes that the Bank's primary purpose is to create wealth in accordance with its stated purpose within its strategic framework. Hence, the Board determines the strategic objectives of the bank in line with its vision and mission and establishes organizational structures and procedures to achieve these objectives. The board regularly reviews the strategy to ensure its relevance as well as monitor its implementation ensuring effective control over the Bank.

The board of HFCK is involved in strategic planning and policy decisions. Other functions of the board include; monitoring and evaluating the company's performance, ensuring quality of service, strategy development, recruitment of the Managing Director and sanctioning the annual budget estimates. The board yields strong influence on the direction and control of the company. In all instances the board was involved when a new branch was being opened, approval of expenses beyond the approved budget, changing auditors and authorising annual capital expenditures. The Board also ensures that Bank always has a qualified, competent, fit and proper company secretary who must have the requisite knowledge and experience necessary to undertake the statutory duties and responsibilities of the post and advise the Board. The Company Secretary has the responsibility for ensuring that the Bank adheres to the code of best practice for corporate governance.

4.3 Board Committees

The Board has constituted four sub-committees chaired by Non-Executive Directors, namely; Audit, Risk Management, Nominating and Remuneration and the Credit Committee. Audit Committee members are independent non-executive directors. The Board considers that each member has appropriate professional qualifications and brings broad experience and knowledge of financial reporting to the Committee's deliberations. The Committee reviews and monitors the integrity of the Company's annual and interim financial statements, circulars to shareholders and any formal announcements relating to the company's financial performance, including significant financial reporting judgments contained within them. The Committee also reviews the appropriateness of the company's accounting policies, recommendations for provisions against bad or doubtful loans and other credit exposures. Ultimate responsibility for the approval of the annual and interim financial statements rests with the Board. At least once a year, the Audit Committee meets separately with the external auditor and the Head of Internal Audit without management being present to discuss any issues arising from the audit. In relation to the Internal Audit function, the Committee's responsibilities include; monitoring and assessing the role and effectiveness of the Internal Audit function and receiving reports on these matters; and considering the appointment, resignation or dismissal of the Head of Internal Audit.

In relation to the company's external auditor, the Committee's responsibilities include; considering and making recommendations to the Board on the appointment, re-appointment, resignation or dismissal of the external auditor; approving the terms of engagement, nature and scope of the audit; and reviewing the findings of the audit including any major issues that arose during the course of the audit. Risk Management Committee is composed of three non-executive Directors and the

Managing Director whose primary responsibility is to ensure the quality, integrity and reliability of the Company's risk management framework. The Committee reviews and assesses the integrity of the risk control systems and ensures that the risk policies and strategies are effectively managed. The basic principles of risk management that are followed and enforced through the Risk Management committee include; the Board assumes the ultimate responsibility for the level of risks taken by the company and is responsible to oversee the effective implementation of the risk strategies; the organizational risk structure and the functions, tasks and powers of the employees, committees and departments involved in the risk processes are continuously being reviewed to ensure clarity of their roles and responsibilities; risk issues are taken into consideration in all business decisions; identified risks are reported in a transparent and timely manner and in full to the responsible senior management; and appropriate, effective controls exist for all processes entailing risks.

Nomination and Remuneration Committee members are independent non-executive directors with the exception of the Managing Director. The Committee's responsibilities include; reviewing the structure, size and composition of the Board to ensure the optimum balance of skills, knowledge and experience taking into account the opportunities and challenges which face the Company, identifying and nominating for the approval of the board suitable candidates for any board vacancy which may arise, monitoring the development of succession plans for the company relating to senior executive management and reviewing the emoluments of both executive and non executive Directors, and senior management. This Committee carries out a peer and self-evaluation of the board and its committees to assess their contribution and also to ensure that there is the requisite mix of skills and experience available to effectively discharge their duties.

Credit Committee is comprised of four Non-Executive Directors. The primary responsibilities of the Board Credit Committee are, review and oversee the overall Credit policy and ensure that the risk lending limits are reviewed annually as and when the environment so dictates; deliberate and consider loan applications beyond the limits of Management Lending Committee; direct, monitor, review and consider all

issues that may materially impact on the present and future quality of the Company's credit risk management; ensure that the credit policy sets out acceptable levels of exposure to the various economic sectors, currencies and maturities as well as target markets, diversification and concentration of the credit portfolio. This is the only Board Committee that carries out its duties without formally constituted meetings. All the business of the Board Credit Committee is carried out via circulation of papers and virtual meetings.

4.4 Board Meetings

According to the study the board meets quarterly. The CBK prudential guidelines provide a direction on the interval of board meetings. The quorum required to conduct business is five members. The board Chairman and the managing Director create the agenda for the meetings. The board was found to be very committed in attending the board meetings. Board evaluation was conducted annually as recommended by CBK and disclosure of the evaluation is done in the annual reports. Training of the board members was found to be scanty.

The stakeholders of HFCK were found to be the shareholders, employees, suppliers, depositors, borrowers, government and the community at large. Some of the good governance practices found included authority matrix for incurring expenses, quarterly board meetings, loan approval authority matrix, regular internal audit reports, separation of the roles of the board Chairman and the Managing Director, and an independent audit function which reports directly to the board audit committee. Policies and procedures of the company are documented and they are shared with all employees through the company intranet.

4.5 Role of Shareholders

Shareholders are required to obtain copies of the memorandum and articles of association, study, understand and where necessary obtain independent professional advice on the instruments constituting the Bank. Shareholders endeavour to understand clearly the objects, for which the Bank is formed, the duties and limitation of the authority of the directors, their own rights and obligations; the obligations of the Bank to other parties such as creditors; and the voting procedures. They ensure that the Memorandum and Articles of Association do not give anyone member or block of members unfettered power. They endeavour to ensure that the constituting instruments, being the contract between themselves and the directors to whom they cede power over their resources clearly defines the relationship between themselves and the Board of Directors and further that it defines the limits of the authority of the Board. Shareholders commit to ensure that the Memorandum and Articles of Association of the Bank are consistent with the principles of good corporate governance and where necessary make amendments to bring them in line with the principles of good corporate governance.

The members are required to ensure that only competent and reliable persons of integrity, who add value, are elected as directors. In electing directors, they ensure that a majority of independent, nonexecutive directors who possess the mix of skills and competencies, sound business acumen, integrity, innovativeness, focused intelligence and commitment and devotion to duty are appointed to the Board. They further ensure that the Memorandum and Articles of Association of the Bank facilitate regular alteration of the mix and composition of the Board. Members dismiss directors who are not transparent, accountable and responsible, who do not uphold the principles of good corporate governance, those who do not provide effective leadership such that the Bank does not prosper.

Members ensure that the Board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability. Members ensure that there is adequate and timely disclosure by directors regarding their dealings with the Bank including but not limited to remuneration, contracts, loans and actual and potential conflicts of interest. Members ensure that only competent and reliable auditors are appointed. Members also ensure that where directors recommend the appointment of an auditor rather than the retiring auditor, that the reasons for the same are bona fide. Members ensure that they receive and consider the report of the auditors and that the Annual General Meeting, an annual report, accounts, auditors report and a report of directors are tabled by directors in accordance with the Law. The Annual Report include corporate governance reporting where the directors report to them the extent to which they have complied with the principles of good corporate governance. Members carefully study the annual report and accounts and where necessary seek Professional advice on the same and ensure that the Bank is a responsible corporate citizen and has due regard to the interest of all stakeholders and the community within which they operate.

4.6 Disclosure and Supply of Information

On first appointment and at regular intervals (at least once every year), or at any time when circumstances change, all directors, in good faith, disclose to the Board for recording and disclosure to the external auditors, any business or other interests that are likely to create a potential conflict of interest, including; all business interests (direct or indirect) in any other company, partnership or other business venture; membership in trade, business or other economic organizations; their shareholding, share options and/or other interest in the Bank; any interest (direct or indirect) in any transaction with the Bank; any gifts, monies, commissions, benefits or other favours extended or received from whatsoever party in respect of or in relation to any business dealings with the Bank. If a director resigns or is removed from office before the expiry of term, the director discloses to the Bank's external auditors and if necessary to the members (if the reason for removal or resignation is refusal to compound fraud, corruption or other activities or behaviour incompatible with the shareholders' interests) the reasons for the resignation or removal.

For Board members to exercise informed, intelligent, objective and independent judgments on the Bank's affairs, they have access to accurate, relevant and timely information. In this regard; there is an established formal procedure to enable independent directors to take professional advice on any matter pertinent to their functions if and where they deem it necessary and at the Bank's expense but subject always to the limitations, restrictions and conditions stipulated by the Board. All directors have unlimited access to the advice and services of the Bank's Secretary who has a statutory duty to advice the Board on maters of procedures, Memorandum and Articles of Association and regulations, and to any other professional officer of the Bank. It is the duty of every director to demand and obtain any information he deems critical to the performance of his duties as a director.

The Bank recognizes the need for regular, continuous accounting to members and other stakeholders. The Bank further appreciates that effective corporate reporting requires an integrated approach including both financial and non-financial reporting.

The Board ensure that in reporting to members and stakeholders that it includes reports including but not limited to the following; corporate performance (both financial and non-financial) over the period under review and future prospects, governance principles and adherence to the same, board composition, mix, competencies, balance of powers and succession planning, roles and responsibilities of Directors, other issues relevant to directors such as access to information, training and development, compensation, disclosure, related party transactions, regularity and effectiveness of meetings, board Committees, Human capital acquisition, retention, development, deployment and succession planning

Directors have the duty to cause the keeping of proper and accurate books of accounts in respect of all sums of money received and expended by the Bank, and the matters in respect of which receipt or expenditure takes place; all sales and purchases by the Bank; and of all the assets and liabilities of the Bank, as necessary to give with reasonable accuracy at any time, the financial position of the Bank at that time; and to lay before the Bank's annual general meeting, a profit and loss account and a balance sheet reflecting a true and fair view of the profit or loss of the Bank and of the state of affairs of the Bank.

4.7 External Auditors, Internal Audit, Corporate Citizenship, Training and Development

The Board ensures that persons recommended for appointment as auditors are qualified, reliable and independent of the Board and management. The auditors are required to extend the definition and scope of audit to provide an independent opinion to those with interest in the Bank that they have received from those responsible for the direction and management of the Bank an adequate account of; the proper conduct of the Bank's affairs; the Bank's financial performance and position and future risks. The board is tasked to facilitate the extension of Auditors duties in regard to; reporting on whether the Bank has financial and other risk management controls, evaluating and reporting on aspects of propriety and efficiency, reporting directly to the Board, regulatory authorities and shareholders as appropriate, when illegal acts are discovered and to monitor basic ethical behaviour particularly in regard to the public interest. The board is expected to enhance the independence of the auditor from the Board and management.

The Board puts in place and ensures an effective internal audit system to enable a: systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. The Board ensures that the internal audit function is independent of the activities audited and that internal auditors are objective in performing their work notwithstanding that those performing the function may be employees of the Bank. The Board ensures that the internal audit team has a standing that commands respect. The Head of internal audit while reporting administratively to the chief executive officer, reports functionally to the Audit Committee and has unfettered access to the chair of the Audit Committee as well as the chair of the Board.

The Bank underscores its commitment to being a good corporate citizen and ensuring that it effectively balances the need for long-term viability and prosperity of the Bank with that of the society on which it relies for its ability to generate economic value with the requirement for short term competitiveness and financial gain. Consequently, the Board ensures that the Bank has clear corporate values which are stated and enacted, that the Bank is governed in a way that is efficient, responsible, accountable, and transparent and with probity. The rights of members and specifically their right to expect a good return on investment and growth in the medium to long term are recognized. The Bank is committed to investing for the long-term and as such developing long term relationships and appreciates and differentiates accountability linkages to members and responsibility linkages to other stakeholders. Therefore the Bank is open in structure, process and disclosure and has open communication and engagement with key stakeholders.

All directors receive some formal training on their role, duties, responsibilities and obligations as well as Board practices and procedures on first appointment covering: Role, duties and responsibilities of the Board and directors, rights and obligations of a director, statutory liabilities and duties of a director under criminal and company law., Board practices and procedures, corporate strategy and organization, disclosure and communication policies, financial management systems, internal control procedures and internal audit, external Audit and the Board, the Corporate Environment, performance targeting, monitoring and evaluation, risk management, information Technology and information to the Board, any other matters of interest to the Board. Directors are exposed, at least once every three years, on matters

-elevant to legal reforms, corporate governance, changing corporate environment, business risks and other matters that may be of interest in the execution of their role.

CHAPTER FIVE SUMMARY, CONCLUSIONS AND RECOMENDATIONS

5.1 Summary of Findings

HFCK has been in Kenya since the year 1965. Apart from the Managing Director the rest of the board members are non-executive. Regarding the composition of the Board in terms of professional qualifications, there exist a professional mix which includes legal, banking, finance, insurance, audit, Economics and business management. It was noted that majority of Board members are professionals in the areas of banking and Finance followed by Law. Men form the majority in the Board members and only two ladies are in the board.

The powers of the Board that were mentioned include, policy making and decisions, performance reviews, compliance audits and corporate governance. Responsibilities of the Board include policy formulation in accordance with the relevant Acts, keeping proper books of accounts, preparation of financial statements, provision of leadership, formulation of strategies, receiving and approving reports of committees, approval of key financial objectives, budgets and business reports, good corporate governance, approval of loans and expenditures through the budgetary process, ensuring compliance to statutory and regulatory frameworks, banking projections and safeguarding the assets of the bank. In the study, it was also noted that the responsibilities of the Board are clear to both the Directors and the management.

It was also noted that there was a board manual and a documented board code of ethics and conduct. These documents guided the conduct and composition of the board. There were no instances of conflict or overlap reported in regard to the responsibilities of the board and management. Regarding the Board's effectiveness in terms of leadership, integrity, enterprise, judgement and decision making, it was found out that the Board was effective. The board conducts four meetings in a year. The directors receive board papers at least one week before a board meeting. The Board's deliberations are communicated to shareholders and stakeholders through circulation of minutes at the Annual General Meeting. The most commonly used mode of decision making by Boards is consensus.

It was found out that the board does self performance and effectiveness assessment, for both the board itself and the members individually. They also conduct the performance and effectiveness assessment of the Managing Director. These assessments are normally done annually and disclosed in the annual report as required by the CBK guidelines on corporate governance.

HFCK has a comprehensive induction programme for new board members. On appointment, each Director is provided with a comprehensive and tailored induction process covering the Group's business and operations and provided with information relating to their legal and regulatory obligations. All non-executive Directors are required to submit themselves for re-election in accordance with the Company's Articles of Association. It was noted that there was no training or development programme for the board members. This makes its quite challenging for the board to acquaint themselves with upcoming development in the areas of banking governance practices None of the board members was providing any contractual services to the bank. However the board manual prescribes that if there is a member interested in providing services to the company he should disqualify himself from deliberations of the tender awards.

The directors receive compensation for their services on the board. They are paid allowances which are recommended by the board itself and approved at the company's annual general meeting. The board manual spells out clearly that the position of the chairman and that of the Managing Director shall always be occupied by different persons. There exists a documented and approved succession plans for the Board, Managing Director and senior management.

The Board of Directors of the bank determine the purpose and values of the bank and also the strategies. Everybody in a management position including the board and the Managing Director ensures that the procedures and values that protect the assets and reputation of the bank are put in place. There are measures in place to ensure that the bank comply with all relevant laws, regulations, governance practices, accounting and auditing standards. The bank has a risk management committee which reports to the board on all company wide risk matters through the company's risk and compliance officer.

The bank operates under the following legal framework, the Banking Act, the Central Bank of Kenya Act, the Companies Act, Capital Markets Authority Act, Finance Act, Central Depository System Act, Capital Market Regulations (Corporate Governance Guidelines, Securities, Public offers and disclosures, Collective Investment Scheme, Takeovers and Mergers, Rating Agency Approval Guidelines) and Income Tax Act. The bank has systems in place to ensure that the regulation requirements from the above mentioned bodies are adhered to.

5.2 Conclusions

The Board of HFCK is responsible for the overall management of the bank and is committed to ensuring that its business and operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices in corporate governance.

In recent years various recommendations have been made in several legal and professional publications in an attempt to determine the most appropriate way for companies to be structured to achieve the highest standards of corporate governance. The study noted that the Board is committed to full compliance of all the relevant laws including The Guidelines on Corporate Governance issued by the Central Bank of Kenya in January 2006 under Section 33(4) of the Banking Act and The Guidelines on Corporate Governance Practises by Public Listed Companies in Kenya issued by the Capital Markets Authority in May 2002 under Cap 485 A of the Capital Markets Authority Act.

The Board is responsible for drawing and implementing strategies for the long-term success of the company as well as carrying out the fiduciary duty of monitoring and overseeing the activities of management. To this end the Board meets regularly and has a formal schedule of matters reserved for its decision. These matters include determining and reviewing the strategy of the Company and the Group and overseeing the company's compliance with statutory and regulatory obligations. Notices and agenda for all Board meetings are circulated to all Directors on a timely basis together with the respective documents for discussion.

The board of the bank is headed by an effective board that offer strategic guidance, leadership and control to the company and is accountable to the shareholders. The study has established that in terms of leadership, integrity, enterprise, judgement and decision making, the board is quite effective.

Appointments to the Board are formal and transparent. The procedure for the appointment of directors to the board and all persons offering themselves for appointment, as directors discloses any potential area of conflict that may undermine their position or service as director. The appointment procedures recorded include: vote of majority shareholders, nomination by the board and the approval of appointment is done by the Shareholders, and CBK. It was noted that none of the Directors was providing contractual services to the bank.

Regarding the tenure of office; it is was found that the non-executive directors have a fixed service contract not exceeding five years with a provision to renew subject to regular performance appraisal; and shareholders approval.

The succession plans for the Board, CEO and senior management do exist. Some of the secession plans recorded include, external and internal training for management and arrangement where every head of a division has a deputy. There is also a comprehensive leadership training programme which is managed by the Human Resources Director.

According to the CMA corporate governance regulations, the board of directors are expected to assume a primary responsibility of fostering the long-term business of the bank consistent with their fiduciary responsibility to the shareholders. The study established that the core responsibilities of the HFCK Board include; policy formulation in accordance with the relevant Acts, preparing and keeping proper books of account, provision of leadership, formulate strategies, receive and approve reports of committees, approve key financial objectives, budgets and business reports.

The board has established various committees as mentioned earlier. The responsibilities of the board are delegated to these committees who eventually make their presentations and recommendations to the full board. The committee method of managing board affairs is a good way of tapping the expertise of the respective board members. The committee method is also a way of authority and power devolution within the board.

The bank has established a formal and transparent procedure for remuneration of directors. The directors receive compensation for their services to the board. These compensations include Directors fees and Sitting allowances. The remunerations are determined by the board members and approved by the shareholders at the Annual General Meetings as the regulations stipulate.

According to the corporate governance guidelines by the Capital Markets Authority, the board should be composed of a balance of executive directors and non-executive directors of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the boards' decision-making processes. The study established that HFCK had non executive Board members with the exception of the Managing Director. The board was also found to be having a balanced professional mix though lacking the skills of Human Resources management and fund raising.

The study established that there exists a clear separation of the role and responsibilities of the chairman and the Managing Director to ensure balance of power of authority and provide for checks and balances such that no one individual has unfettered powers of decision making.

The company is committed to ensuring that shareholders and the financial markets are provided with full and timely information about its performance; and compliance with regulations and obligations applicable to the Stock Exchange and the Capital Markets Authority. Information is distributed to the shareholders through an annual report and press notices following the release of quarterly, half yearly and annual results. Press releases on significant developments are also reported.

5.3 Recommendations

The study found out that the corporate governance procedures applied at HFCK have been effective to a great extent in achieving the goals and objectives upon which they were set. It is therefore recommended that strategic training for board members and senior bank managers be intensified by stakeholders in corporate governance to promote good corporate governance in these institutions. They should be guided to understand that to remain competitive in a changing world, banks must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities and the government has an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders.

Banks should be assisted to develop principles of corporate governance that cut across all the functions of the banks.The strengths of the existing legal framework overweigh the weaknesses. The existing corporate governance procedures within the banks as established by this study are still not effectively implemented. There is need for stakeholders to play an effective role in assisting the banks with necessary professional and technical assistance towards the implementation of these.

The regulatory and supervision systems have been issued by the Central Bank of Kenya. Some banks have also developed own in-house systems to ensure this. More in-house systems are further recommended so that those systems that have been introduced through statutes can be supplemented by the in-house systems and enforcement.

5.4 Limitations of the Study

There was limitation of time. Had time been adequate a more detailed study could have been done towards mapping the corporate governance practices at HFCK to other key business drivers and business practices. The case study design used was a limitation. A case study cannot answer a large number of relevant and appropriate research questions. Case studies are neither ubiquitous nor a universal panacea. There are very many important research questions that cannot be answered in this way.

5.5 Suggestions for Further Research

A study can be carried out to determine the correlation between good governance and employee motivation at HFCK. The presence of employees makes it possible to have governance body separate from the management, which is a major pillar of corporate governance.

Also a study can be conducted on whether there is any relationship between good corporate governance and good customer service. Nowadays one of the key business drivers is good customer service and hence the need to have this coming right from the governance level and therefore the need to test the relationship.

Other studies on corporate governance could be done using other forms of research designs like a survey. This will illuminate the similarity of corporate governance practices across organisations and also help to inform the level of implementation of best practice corporate governance within and across sectors.

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APPENDIX I

QUESTIONNAIRE

STUDY OF CORPORATE GOVERNANCE PRACTICES IN HOUSING FINANCE COMPANY OF KENYA

1 Introduction

1.1 Company year of establishment

1.2 Name of respondent

1.3 Title

2 Board Composition

2.1 How many members are on the board of directors?

2.2 How many live overseas

2.3 How many board members are employees of the organisation?

2.4 What skills are represented on your board?

[a] Legal

[b] Financial

[c] Public relations

[d] Auditing/Accounting

[e] Micro enterprise expertise

[f] Others - specify.

2.5 What is the typical manner in which board members are nominated and selected?

[a] By managing director

[b] By Board Chairman

[c] By the vote of majority shareholders

[d] Vote by all shareholders

[e] By the old board when a new one is coming into office

[f] By other board members

[g] By executive search team

[h] Others - specify

2.6 What is the length of terms for board members (Choose one)

[a] 1-12 months

[b] 13-24 months

[c] 25-36 months

[d] 37 + months

[e] No set terms.

2.7 Are the board terms renewable (choose one)

[a] Yes indefinitely

[b] Yes for renewable terms

[c] No

[d] Not applicable

2.8 How is the board chairman nominated (Please describe)

2.9 What is the length of terms for the chair (choose one)

[a] 1-12 months

[b] 13-24 months

[c] 25-36 months

[d] 37 + months

[e] No set terms.

2.10 Is the Chair's term renewable?(choose one)

[a] Yes indefinitely

[b] Yes for renewable terms

[c] No

[d] Not applicable

2.11 What officers does the board elect?

2.12 How important are the officers to the proper functioning of the board (choose one)

[a] Very important

[b] Important

[c] Somewhat important

[d] Not important.

3 Board Structure

3.1 Please complete the table below that outlines information on board committees, list in order of importance to the proper functioning of the organisation

SR#	Committee Name	# of members involved	Number of meetings per year	Responsibilities
1				
2				
3				
4				
5				

3.2 For which of the following does the organisation maintain documents (mark all that apply)

[a] Organisation policies
[b] Credit policy
[c] Board meetings minutes
[d] Strategic /business plan
[c] Employee job description

3.3 What factors does the board consider when assessing the performance of the CEO.

3.4 How do you ensure effective shareholder communication apart from holding the general meetings?

3.5 What training is available for Directors?

4 Board Balance

4.1 What is the numbers and proportion of non-executives on the board?

4.2 Where non-executive directors comprise less than one third of the board, are there steps being taken to recruit more

4.3 What are the criteria for defining an independent non-executive director?

4.4 What is the composition of the board in terms of professional qualification?

[a] lawyers [give number__________]

[b] Banking and finance specialists [_________]

[c] CPA [________]

[d] Engineers [________]

[e] Economists [________]

[f] Other professions [list and give numbers]

4.5 What is the composition of the board in terms of gender?

[a] male

[b] female

5 Accountability and Audit

5.1 Does the annual report contain a statement of directors responsibility for preparing the accounts and external auditors statement concerning their responsibilities.

5.2 How much information is provided about the assumptions or qualifications supporting the director's going concern statement if any...

5.3 How long have you been with your current external auditors?

5.4 Does your current auditor play any other role other than audit?

5.5 What matters are handled by the internal audit function? Rank in order of priority beginning with the most important. [1=most important 5=least important)

- Vouching
- Budgetary control
- Procedure compliance
- Economic value assessment
- Liaison with external auditor

5.6 Do all directors and senior company executives understand the concept of corporate governance and its significance to the company and its shareholders?

6 Board Meetings

6.1 How often does the board meet (number of times per year)

6.2 What number of board representation is required to constitute a quorum to conduct business?

6.3 Who creates the agenda for the meeting?

[a] Chairman

[b] Managing Director

[c] Managing Director with board members

[d] Other

7 Role of the Board

7.1 Which description best describes the nature of the company's board (mark one)

[a] monitor organisational activities but leaves most decisions up the management

[b] Involved in strategic planning and policy decisions but not involved with operational decision making

[c] Actively involved in many levels of decision making including operational decisions.

please mark items in order of priority that are direct responsibilities of the board (1=very important 2=important 3=somewhat important 4=not important) or an (for not applicable)

[a] Strategic planning

[b] Identify sources of technical assistance/information

[c] Fundraising

[d] Oversee effective management of the company

[e] Approve budget

[f] Attract positive media attention, public relation

[g] Review audit reports

[h] Assessment of managing director's performance

[i] Assess board's performance

[j] hiring/firing senior management

[k] Monitor financial status of the company

[l] Others - specify

For what operational activities is board approval required (mark all that apply)

[a] opening of a new branch

[b] Expenses above a certain amount

[c] Hiring/firing senior management

[d] Introducing new products

[e] Changes in credit policy

[f] Selecting or changing auditors

[g] Other - specify

In your opinion, what is the greatest strength of your board of Directors?

In your opinion what is the greatest weakness of your board of directors?

Institutional Performance

Please complete the table below indicating how often these reports are :

[a] produced by the company

[b] How often they are sent to the board or appropriate committee (times/year)

Type of report	Produced by company	Sent to the board
Balance sheet		
Income statement		
Portfolio report		
Cash-flow statement		
Strategic plan		
Internal audit report		
External audit report		
Market share information		
Performance per loan product		
Social impact statistics		

9 Conflicts and Resolution

9.1 Indicate frequency in which the board has had to deal with the following issues in the last 3 years. (1=most common, 2=fairly common, 3=infrequent, 4=never)

[a] Suspected fraud

[b] Diminishing quality of loan portfolio

[c] Liability issue eg law suit

[d] Over zealous growth exceeding resources

[e] Legal issues e.g. change in tax status

[f] Board unable to reach consensus

[g] Personality conflicts with board

[h] Inactive board members

[i] Staff morale problem

[k] Poor communication (board/management)

[l] Insufficient information from management

[m] Board and management have different visions affecting strategic planning.

[n] Personality conflicts between board and management

9.2 What is the most important issue the board is currently addressing.

9.3 Does the board assess the performance and effectiveness of:

[a] itself?	[1. yes 2. no]
[b] individuals members?	[1. yes 2. no]
[c] the Chief Executive?	[1. yes 2. no]

9.4 If Yes how frequently is this done?

[a] for itself_

[b] for individuals members_

[c] for the Chief Executive_

9.5 Are reports made from these assessments?

[a] yes

[b] No

9.6 At what level are the reports discussed?

[a] board meeting

[b] AGM

[c] Special meetings

[d] Other [indicate]

9.7 Are there continuous members' skill development programmes for the Board?

[a] yes

[b] no

9.8 Is there any training programme for the management and other staff?

[a] yes

[b] no

9.9 Who are the internal stakeholders of the bank?

9.10 Who are the external stakeholders of the bank?

9.11 Is there a policy which guides how the bank should relate with stakeholders?

[a] yes

[b] no

9.12 Who monitors and evaluates the implementation of the bank's strategies, policies, plans and management performance?

[a] the board

[b] the chief executive

[c] the share holders

[d] all departmental heads

[e] everybody in the management position including the board and the CEO

9.13 Who reviews the viability and financial sustainability of the bank?

[a] the board

[b] the chief executive

[c] the share holders

[d] all departmental heads

[e] everybody in the management position including the board and the CEO

9.14 Is there any measure in place to ensure that the bank complies with all relevant laws, regulations, governance practices, accounting and auditing standards?

[a] Yes

[b] No

9.15 Please state the measures

9.16 Who enforces these measures?

[a] the board

[b] the chief executive

[c] the share holders

[d] all departmental heads

[e] everybody in the management position including the board and the CEO

9.17 What suggestions would you make to improve corporate governance in HFCK?